

BEFORE THE TENNESSEE
REGULATORY AUTHORITY

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Joint Application and Request for)
Expedited Treatment of)
ECONOPHONE SERVICES, INC. and)
VIATEL, INC. for Approval of)
Agreement and Plan of Merger)
and for Amendment of Certificate)
of Public Convenience and Necessity)
to Reflect a Name Change to Destia)
Communications Services, Inc.)

EXECUTIVE SECRETARY

Docket No.

99-00732

**JOINT APPLICATION FOR APPROVAL OF
AGREEMENT AND PLAN OF MERGER, NAME CHANGE AND
REQUEST FOR EXPEDITED TREATMENT**

Econophone Services, Inc. ("Econophone") and Viatel, Inc. ("Viatel") (collectively, the "Applicants"), by their undersigned counsel and pursuant to Tenn. Code Ann. § 65-4-112, hereby request Authority approval of a transaction whereby Viatel will acquire control of Econophone. The applicants also hereby request that the Authority amend Econophone's Certificate of Public Convenience and Necessity (the "Certificate") to reflect its new corporate name: Destia Communications Services, Inc. ("DCS").¹

Econophone is a nondominant carrier authorized by the Authority to operate as a reseller of intrastate interexchange telecommunications services in Tennessee. Viatel, an international communications company providing long distance communication and data services primarily in Western Europe, currently does not hold, either directly or indirectly, any authorizations to provide service in Tennessee. As described more fully below, the proposed transfer of control will be accomplished through a transaction whereby Viatel will acquire all of the outstanding

¹ For ease of reference, this entity will be referred to herein as Econophone.

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capital stock of Destia Communications, Inc. ("Destia"), the parent of Econophone, through a merger of Viatel Acquisition Corp., a Delaware corporation and a wholly owned subsidiary of Viatel ("Viatel Acquisition"), with and into Destia. Thereafter, Econophone will become an indirect wholly owned subsidiary of Viatel. Currently, Econophone and Viatel are not affiliated with each other.

Following the merger, Econophone will continue to provide service to its current Tennessee customers under existing service arrangements pursuant to the Certificate and tariff, as amended to reflect Econophone's name change, such that the transfer of control will be virtually transparent to Econophone's customers. *Accordingly, the Applicants respectfully request expedited treatment of this Application in order to permit the consummation of the merger no later than December 1, 1999.*

After discussions with the staff, the Applicants understand that prior Authority approval may not be required for the merger described in this Application because the parent of the certificated entity (rather than the certificated entity itself) is entering into the proposed transaction. The staff therefore has advised the Applicants to submit relevant documentation concerning the proposed merger. If the Authority determines after review of this documentation that prior approval is **not** required, please consider this Application as official notification of the merger.

I. THE PARTIES

A. Econophone

Econophone, a Delaware corporation, is a wholly owned operating subsidiary of Destia. Its headquarters are located at 95 Route 17 South, Paramus, New Jersey, 07652. Econophone is

authorized by this Authority to resell interexchange services throughout Tennessee.²

Econophone operates as a reseller of intrastate interexchange services in 48 states and the District of Columbia.³ In addition, Econophone has an application pending for facilities-based competitive local exchange and interexchange authority in the State of New York.

Destia is a Delaware corporation publicly traded on the Nasdaq National Market under the stock symbol "DEST." Destia is a facilities-based provider of domestic and international telecommunications services in North America and Europe. Destia's extensive international telecommunications network allows it to provide services in many of the largest metropolitan markets in the United States, Canada, the United Kingdom, Belgium, France, Germany and Switzerland. Destia currently offers a broad array of telecommunications services primarily to retail customers, including international and domestic long distance, calling card and prepaid card services and Internet access.

Information concerning Econophone's legal, technical, managerial and financial qualifications to provide telecommunications services was submitted with its application for the Certificate filed with the Authority and is, therefore, already a matter of record at the Authority.⁴ The Applicants respectfully request that the Authority take official notice of the record and of its decision with respect to Econophone's application. In addition, copies of Destia's consolidated financial statements filed with the Securities and Exchange Authority ("SEC") in its May 5, 1999 prospectus and its most recent Form 10-Q, filed with the SEC on August 13, 1999, are attached

² *In re Petition of Econophone, Inc. and Econophone Services, Inc. for Approval of Transfer of Authority*, Order Granting Approval of Transfer of Authority, Docket No. 98-00488 (March 12, 1999).

³ Econophone also holds a certification to resell intrastate interexchange service in Hawaii, but is not currently providing service in that state. Econophone is not certificated and does not provide service in Alaska.

⁴ *See* Petition for Approval of Transfer of Authority, Docket No. 98-00488 (filed July 21, 1998).

hereto as Exhibit 1 and Exhibit 2.

B. Viatel, Inc.

Viatel is a Delaware corporation, publicly traded on the Nasdaq National Market under the stock symbol "VYTL." A copy of Viatel's Certificate of Incorporation is attached as Exhibit 3. Viatel's headquarters are located at 685 Third Avenue, 24th Floor, New York, New York 10017. Viatel is a rapidly growing international communications company providing high quality, competitively priced, long distance communication and data services to end-users, carriers and resellers. Viatel currently operates one of Europe's largest pan-European networks, with points of presence in 45 cities. Currently, Viatel is constructing the Circe Network, a series of interconnected state-of-the-art, high quality, high capacity, self-healing fiber optic rings utilizing the synchronous digital hierarchy standard for digital transmission, which will connect major cities in six Western European countries. The Federal Communications Commission, pursuant to Section 214 of the Communications Act of 1934, has approved authorizations for Viatel to provide facilities-based and resale services to all permissible international points.⁵ In the United States, Viatel is authorized to resell intrastate long distance communication and data services only in New York, but currently does not offer such services in that state.

Viatel has more than sufficient legal, financial, technical and managerial qualifications to acquire control of Econophone. As stated in Viatel's consolidated financial statements submitted in its 1998 Annual Report (attached hereto as Exhibit 4), as of December 31, 1998, Viatel had assets worth over \$1 billion and revenues derived from communication services of more than \$135 million. For the six months ended June 30, 1999, revenues exceeded \$130 million and

⁵ *Viatel, Inc.*, Global Facilities-Based and Resale Service Grant of Authority, FCC File No. ITC-96-421, Public Notice Report No. I-8201, released September 12, 1996, effective September 6, 1996. Viatel also holds more narrow authorizations under Section 214 that are effectively subsumed by the global authorization cited above.

assets grew to more than \$1.6 billion, as reflected in the most recent 10-Q filed with the SEC on August 6, 1999 (attached hereto as Exhibit 5). Viatel is managed by a team of highly qualified executives with many years of both managerial and technical experience in the telecommunications industry. A list of Viatel's senior management personnel, with accompanying biographies, is attached hereto as Exhibit 6.

C. Designated Contacts

The designated contacts for questions concerning this Joint Application are:

For Econophone:

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For Viatel:

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II. REQUEST FOR APPROVAL OF TRANSFER OF CONTROL

Destia and Viatel have determined that they can realize significant economic and marketing efficiencies, and, ultimately, strengthen the respective businesses of the two companies by establishing Destia as a direct, wholly owned subsidiary of Viatel. Accordingly, on August 27, 1999, Viatel, Viatel Acquisition and Destia executed an Agreement and Plan of Merger (the "Merger Agreement"), a copy of which is attached hereto as Exhibit 7. Resolutions of the boards of directors of Viatel and Destia authorizing the execution of the Merger Agreement and approving the transaction are attached hereto as Exhibit 8. The proposed transaction is structured as a merger of Viatel Acquisition, a wholly owned subsidiary of Viatel created specifically for the purposes of consummating the transaction with and into Destia, with Destia as the surviving entity. By virtue of the merger, Econophone will become an indirect wholly owned subsidiary of Viatel. Exhibit 9 illustrates the U.S. corporate structure of Destia and Viatel prior to the merger and the U.S. corporate structure of Viatel immediately following completion of the merger. Exhibit 10 lists the current officers and directors of Viatel and those persons who will serve in such capacities after the merger.

As consideration for the proposed transaction, Viatel will exchange 0.445 share of its common stock for each Destia share. The Applicants plan to consummate the transaction in early December 1999, subject to regulatory approvals and other customary conditions.

Although the merger will result in a change of the ultimate corporate parent of Econophone, it will not result in a change in the manner in which Econophone provides service to its Tennessee customers.⁶ Econophone will continue to provide seamless service to existing Tennessee customers pursuant to the Certificate, with no change in the rates, terms or conditions of service as a direct result of the merger. Econophone's Tennessee operations will continue to

be led by a team of well-qualified telecommunications managers comprised, in part, of existing Econophone personnel. In addition, these personnel will be able to draw upon the resources and experience of the Viatel management and operational personnel to augment their ability to provide the Tennessee customers with high quality, state-of-the-art services. The Applicants therefore expect that the substantial managerial, technical and financial expertise of the combined management and operational personnel will assure that this transaction will not in any way disrupt service or cause inconvenience or confusion to Econophone's Tennessee customers. As such, the merger through which Econophone will become an indirect wholly owned subsidiary of Viatel will be virtually transparent to the Tennessee customers. The Applicants request that the Authority approve this Application on an expedited basis.

III. REQUEST FOR APPROVAL OF NAME CHANGE

Econophone also asks that the Authority amend the Certificate to reflect a change in its corporate name from Econophone Services, Inc. to Destia Communications Services, Inc. The company believes that this name change is consistent with its marketing objectives and strategies and will facilitate the promotion of its identity as a global telecommunication services provider. Although the name change has not yet been effected before the Authority, it has been registered with the Secretary of State of Tennessee. The Application for Amended Certificate of Authority filed with the Secretary of State of the State of Tennessee reflecting the name change is attached hereto as Exhibit 11. A copy of DCS's Certificate of Authorization, duly certified by the Secretary of State of the State of Tennessee, is attached hereto as Exhibit 12.

The proposed name change will have no material effect on the day-to-day operations of the company. Econophone has been advising its customers of the name change, and over the

⁶ Econophone's toll-free customer-service number is (800) 454-7091.

next several months, the Econophone name will be phased out. Branding for Econophone's services will reflect the name "Destia Communications Services, Inc." or appropriate variation thereof. The rates, terms and conditions of services currently offered by Econophone to its customers will not be affected by the name change. In short, the name change will have no adverse impact upon the company's customers in Tennessee.

IV. PUBLIC INTEREST CONSIDERATIONS

Viatel and Destia are among the most entrepreneurial, competitive, innovative and growth-oriented companies in the telecommunications industry. Consummation of the proposed transaction will serve the public interest by combining the financial resources and complementary operating, technical and managerial strengths and experience of both companies. The Applicants anticipate that the proposed transaction will result in a more efficient company better equipped to accelerate its growth as a competitive telecommunications service provider. Thus, the transfer of control will enable Econophone to strengthen its competitive position in Tennessee, which will inure to the benefit of consumers through improved service. The transfer will ensure the continued provision of high quality, affordable telecommunications services to Econophone's existing customers and should promote competition in the Tennessee telecommunications service market by offering consumers a cost effective, high quality competitive alternative to the most powerful players in the telecommunications market.

V. CONCLUSION

For the reasons stated herein, the Applicants respectfully request that the Authority: (1) approve this Joint Application, and thus permit Destia and Viatel to consummate their proposed transaction no later than December 1, 1999; (2) approve the amendment of Econophone's Certificate of Public Convenience and Necessity to reflect the change in corporate name to

Destia Communications Services, Inc.; and (3) grant all other relief as necessary and appropriate to effectuate the transaction described herein.

Respectfully submitted,

VIATEL, INC.

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Its Attorneys

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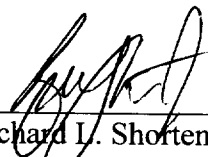
Its Attorneys

Dated: September 24, 1999

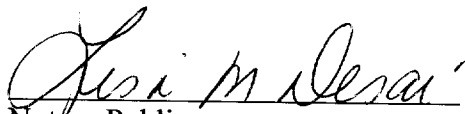
VERIFICATION

I, Richard L. Shorten, Jr., hereby state the following under penalty of perjury. I am Senior Vice President, General Counsel and Secretary of Destia Communications Services, Inc. (formerly Econophone Services, Inc.), an applicant in the subject proceeding, and I am authorized to make this verification on its behalf. I have read the foregoing Joint Application. The statements in the Joint Application are true of my own knowledge, except as to the matters which are therein stated on information or belief, and as to those matters I believe them to be true.

By: _____


Richard L. Shorten, Jr.
Senior Vice President,
General Counsel and Secretary

Subscribed and sworn to before me
this 24th day of September, 1999

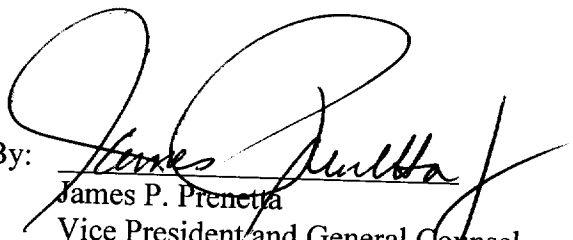

Notary Public

LISA M. DESAI
NOTARY PUBLIC OF NEW JERSEY

My Commission Expires: _____
My Commission Expires Nov. 6, 2002

VERIFICATION

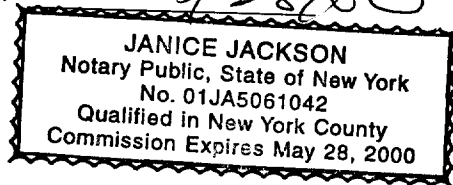
I, James P. Prenetta, hereby state the following under penalty of perjury. I am Vice President and General Counsel of Viatel, Inc., an applicant in the subject proceeding, and I am authorized to make this verification on its behalf. I have read the foregoing Joint Application. The statements in the Joint Application are true of my own knowledge, except as to the matters which are therein stated on information or belief, and as to those matters I believe them to be true.

By: 
James P. Prenetta
Vice President and General Counsel

Subscribed and sworn to before me
this 24th day of September, 1999


Notary Public

My Commission Expires:



PROSPECTUS

6,500,000 Shares



Destia Communications, Inc.

(formerly Econophone, Inc.)

COMMON STOCK

Destia Communications, Inc. is offering 6,500,000 shares of its common stock. This is our initial public offering and no public market currently exists for our shares.

Our common stock has been approved for listing on the Nasdaq National Market under the symbol "DEST."

***Investing in the common stock involves risks.
See "Risk Factors" beginning on page 12.***

PRICE \$10 A SHARE

	<u>Price to Public</u>	<u>Underwriting Discounts and Commissions</u>	<u>Proceeds to Company</u>
Per Share	\$10.00	\$.70	\$9.30
Total	\$65,000,000	\$4,550,000	\$60,450,000

The Securities and Exchange Commission and state securities regulators have not approved or disapproved these securities, or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

Destia Communications, Inc. has granted the U.S. underwriters the right to purchase up to an additional 975,000 shares to cover over-allotments. Morgan Stanley & Co. Incorporated expects to deliver the shares to purchasers on May 11, 1999.

MORGAN STANLEY DEAN WITTER

CREDIT SUISSE FIRST BOSTON

LEHMAN BROTHERS

May 5, 1999

DESTIA COMMUNICATIONS, INC.
(formerly ECONOPHONE, INC.)

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Stockholders of
Destia Communications, Inc. (formerly Econophone, Inc.):

We have audited the accompanying consolidated balance sheets of Destia Communications, Inc. (formerly Econophone, Inc.) (a Delaware corporation) and subsidiaries as of December 31, 1997 and 1998, and the related consolidated statements of operations, comprehensive loss, stockholders' deficit and cash flows for each of the three years ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Destia Communications, Inc. (formerly Econophone, Inc.) and subsidiaries as of December 31, 1997 and 1998, and the results of their operations and their cash flows for each of the three years ended December 31, 1998, in conformity with generally accepted accounting principles.

Arthur Andersen LLP

New York, New York
February 2, 1999

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 1997 AND 1998
(in thousands, except share data)

	December 31,		Pro Forma December 31,
	1997	1998	1998
			(unaudited)
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents	\$ 67,202	\$ 118,218	
Marketable securities	—	21,343	
Accounts receivable, net of allowance for doubtful accounts of \$1,594 and \$4,086, respectively	16,796	33,351	
Prepaid expenses and other current assets	1,868	3,409	
Restricted cash and securities	10,463	9,590	
Total current assets	96,329	185,911	
PROPERTY, EQUIPMENT AND LEASEHOLD IMPROVEMENTS net of accumulated depreciation and amortization of \$3,690 and \$12,418, respectively (Note 5)			
	24,113	107,249	
Debt issuance costs	6,356	12,244	
Intangible assets, net of accumulated amortization of \$0 and \$1,324, respectively	—	49,488	
Other assets	2,242	2,439	
Restricted cash and securities	48,965	30,877	
Total assets	<u>\$ 178,005</u>	<u>\$ 388,208</u>	
LIABILITIES AND STOCKHOLDERS' DEFICIT			
CURRENT LIABILITIES:			
Accounts payable	\$ 21,101	\$ 33,352	
Accrued expenses and other current liabilities (Note 7)	5,356	31,131	
Interest accrued on Senior Notes	10,462	9,590	
Current maturities of other long-term debt (Note 9)	1,829	16,232	
Current maturities of obligations under capital lease (Note 15)	156	154	
Current maturities of notes payable-related party (Note 13)	315	308	
Deferred revenue	2,568	4,739	
Total current liabilities	41,787	95,506	
OTHER LONG-TERM DEBT (Note 9)	5,657	37,379	
OBLIGATIONS UNDER CAPITAL LEASE (Note 15)	279	193	
SENIOR NOTES (Note 9)	149,680	343,176	
SERIES A REDEEMABLE CONVERTIBLE PREFERRED STOCK (Note 12)	14,328	14,421	—
COMMITMENTS AND CONTINGENCIES (Note 15)			
STOCKHOLDERS' DEFICIT (Note 11):			
Common stock—voting, par value \$.01; authorized 29,250,000 shares; 20,778,321, 20,778,321 and 24,332,142 shares issued and outstanding at December 31, 1997 and 1998 and pro forma, respectively	2	208	243
Common stock—non-voting, par value \$.01; authorized 500,000 shares; 0, 135,890 and 135,890 issued and outstanding at December 31, 1997 and 1998 and pro forma, respectively	—	1	1
Additional paid-in capital	6,082	6,923	21,309
Accumulated other comprehensive loss	(104)	(856)	(856)
Accumulated deficit	(39,706)	(108,743)	(108,743)
Total stockholders' deficit	(33,726)	(102,467)	(88,046)
Total liabilities and stockholders' deficit	<u>\$ 178,005</u>	<u>\$ 388,208</u>	<u>\$388,208</u>

The accompanying notes are an integral part of these consolidated balance sheets.

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	For The Years Ended December 31,		
	1996	1997	1998
REVENUES	\$45,103	\$ 83,003	\$193,737
COST OF SERVICES	35,369	63,707	140,548
Gross profit	9,734	19,296	53,189
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	16,834	37,898	80,092
DEPRECIATION AND AMORTIZATION	1,049	3,615	11,866
Loss from operations	(8,149)	(22,217)	(38,769)
OTHER INCOME (LOSS)	106	102	(747)
FOREIGN CURRENCY EXCHANGE GAIN (LOSS), net	27	(265)	86
INTEREST EXPENSE, net	(296)	(7,748)	(29,514)
Net loss	<u>\$ (8,312)</u>	<u>\$ (30,128)</u>	<u>\$ (68,944)</u>
HISTORICAL			
LOSS PER SHARE (basic and diluted) (Note 2)	\$ (0.41)	\$ (1.50)	\$ (3.31)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES			
OUTSTANDING (basic and diluted) (Note 2)	<u>20,778</u>	<u>20,778</u>	<u>20,846</u>
PRO FORMA LOSS PER SHARE (basic and diluted)(unaudited)			
(Note 2):			\$ (2.83)
PRO FORMA WEIGHTED AVERAGE NUMBER OF COMMON			
SHARES OUTSTANDING (basic and diluted) (Note 2)	<u>21,373</u>	<u>24,332</u>	<u>24,400</u>

DESTIA COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(in thousands)

	For The Years Ended December 31,		
	1996	1997	1998
NET LOSS	\$ (8,312)	\$ (30,128)	\$ (68,944)
OTHER COMPREHENSIVE LOSS, net of tax:			
FOREIGN CURRENCY TRANSLATION ADJUSTMENTS ..	—	(104)	(752)
COMPREHENSIVE LOSS	<u>\$ (8,312)</u>	<u>\$ (30,232)</u>	<u>\$ (69,696)</u>

The accompanying notes are an integral part of these consolidated statements.

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT
FOR THE YEARS ENDED DECEMBER 31, 1996, 1997 AND 1998
(in thousands)

	Common Stock				Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Comprehensive Loss	Total
	Voting		Non voting					
	Shares	Amount	Shares	Amount				
BALANCE, December 31, 1995	20,778	\$ 2	—	—	\$ 392	\$ 316	\$ —	\$ 710
Distribution of S corporation earnings	—	—	—	—	—	(316)	—	(316)
Contribution of capital to C corporation	—	—	—	—	90	—	—	90
Net loss	—	—	—	—	—	(8,312)	—	(8,312)
Accretion of preferred stock	—	—	—	—	—	(15)	—	(15)
Dividends on preferred stock	—	—	—	—	—	(281)	—	(281)
BALANCE, December 31, 1996	20,778	2	—	—	482	(8,608)	—	(8,124)
Net loss	—	—	—	—	—	(30,128)	—	(30,128)
Warrants	—	—	—	—	5,600	—	—	5,600
Accretion of preferred stock	—	—	—	—	—	(91)	—	(91)
Dividends on preferred stock	—	—	—	—	—	(879)	—	(879)
Cumulative translation adjustment . . .	—	—	—	—	—	—	(104)	(104)
BALANCE, December 31, 1997	20,778	2	—	—	6,082	(39,706)	(104)	(33,726)
Net loss	—	—	—	—	—	(68,944)	—	(68,944)
Issuance of non voting restricted shares	—	—	136	1	994	—	—	995
Accretion of preferred stock	—	—	—	—	—	(93)	—	(93)
Change in par value	—	206	—	—	(206)	—	—	—
Cumulative translation adjustment . . .	—	—	—	—	—	—	(752)	(752)
Other	—	—	—	—	53	—	—	53
BALANCE, December 31, 1998	20,778	\$208	136	\$ 1	\$ 6,923	\$(108,743)	\$ (856)	\$(102,467)

The accompanying notes are an integral part of these consolidated statements.

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	For the Years Ended December 31,		
	1996	1997	1998
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss	\$ (8,312)	\$ (30,128)	\$ (68,944)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	1,049	3,615	11,866
Provision for doubtful accounts	291	832	2,603
Accreted interest expense	—	280	17,711
Changes in assets and liabilities:			
Increase in accounts receivable	(887)	(9,682)	(22,100)
Increase in prepaid expenses and other current assets	(350)	(1,004)	(2,175)
Increase in other assets	(1,514)	(3,277)	(791)
Increase in accounts payable, accrued expenses and other current liabilities	3,352	14,975	34,745
Increase (decrease) in interest accrued on senior notes	—	10,462	(872)
Increase in deferred revenue	365	1,708	1,543
Net cash used in operating activities	(6,006)	(12,219)	(26,414)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Net cash paid in acquisitions	—	—	(21,063)
Purchase of marketable securities, net	—	—	(21,343)
Purchases of property and equipment	(4,247)	(13,267)	(76,686)
Net cash used in investing activities	(4,247)	(13,267)	(119,092)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net proceeds from sale of preferred stock	13,061	—	—
Proceeds from line of credit	800	—	—
Repayment of line of credit	(1,000)	—	—
Proceeds from short-term borrowings	5,437	—	—
Repayments of short-term borrowings	(3,309)	(2,128)	—
Proceeds from long-term debt and capital leases	2,232	—	16,390
Repayments of long-term debt and capital leases	(566)	(661)	(7,497)
Repayments of notes payable-related party	(10)	(12)	(7)
Dividends paid	(226)	—	—
Proceeds from senior discount notes	—	149,400	175,785
Proceeds from issuance of warrants	—	5,600	—
Payment of debt issuance costs	—	(6,355)	(7,110)
Proceeds from bridge loan	—	7,000	—
Repayments of bridge loan	—	(7,000)	—
Net cash provided by financing activities	16,419	145,844	177,561
Increase in cash and cash equivalents, (including restricted cash)	6,166	120,358	32,055
Cash and cash equivalents, beginning of period, (including restricted cash)	106	6,272	126,630
Cash and cash equivalents, end of period, (including restricted cash)	\$ 6,272	\$ 126,630	\$ 158,685

The accompanying notes are an integral part of these consolidated statements.

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(in thousands)

	For the Years Ended December 31,		
	1996	1997	1998
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Cash paid during the period for:			
Interest	\$ 210	\$ 505	\$ 24,329
Income Taxes	—	—	—
SUPPLEMENTAL DISCLOSURE OF NONCASH ACTIVITIES:			
Note issued for purchase of minority interest—Telco	\$ —	\$ —	\$ 14,035
Accretion of preferred stock	15	91	93
Accrued dividends on preferred stock	281	879	—
Capital leases executed and notes issued for asset purchases	423	5,754	14,250
DETAILS OF ACQUISITIONS:			
Fair Value of assets acquired	—	—	\$ 1,896
Goodwill	—	—	(50,759)
Liabilities assumed and notes issued	—	—	27,800
Net cash paid for acquisitions	<u>—</u>	<u>—</u>	<u>\$ (21,063)</u>

The accompanying notes are an integral part of these consolidated statements.

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 1997 AND 1998

1. NATURE OF BUSINESS

Destia Communications, Inc. (formerly Econophone Inc.) ("Destia") is a rapidly growing, facilities-based provider of domestic and international long distance telecommunications services in North America and Europe. Its extensive international telecommunications network allows it to provide services primarily to retail customers in many of the largest metropolitan markets in the United States, Canada, the United Kingdom, Belgium, France, Germany and Switzerland.

The Company provides its customers with a variety of retail telecommunications services, including international and domestic long distance, calling card and prepaid services, and wholesale transmission services. The Company's 350,000 customer accounts are diverse and include residential customers, commercial customers, ethnic groups and telecommunications carriers. In each of the Company's geographic markets, it utilizes a multichannel distribution strategy to market its services to its target customer groups. Destia entered the US market in 1993 and the UK market in 1995. In continental Europe, Destia commenced offering its service before the January 1, 1998 liberalization of telecommunications services in those markets.

In February 1998, the New York corporation "Econophone, Inc." (now known as Destia Communications, Inc.) was merged into its wholly owned subsidiary named "Econophone, Inc." (now known as Destia Communications, Inc.) which had been incorporated in the State of Delaware, for the sole purpose of changing the state of incorporation of the Company. The Delaware corporation was the surviving entity in the merger. In connection with the foregoing, the par value of the Company's common stock was changed to \$.01 per share of voting and non-voting common stock from \$.0001.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of Destia and its wholly owned subsidiaries, its 72% owned subsidiary, Econophone Services GmbH (Switzerland) and its 81.25% owned subsidiary America First, Ltd. (England) (collectively, the "Company"). The full amount of the net loss for the year ended December 31, 1997 and 1998 for Econophone Services GmbH and America First, Ltd. have been recorded in the consolidated financial statements of the Company. All significant intercompany balances and transactions have been eliminated in consolidation. See Note 17.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition

The Company's revenues are primarily based on usage and are derived from (1) the number of minutes of telecommunications traffic carried and, (2) generally, a fixed per minute rate. For prepaid services, the Company's revenues are reported net of selling discounts and commissions and are recorded based upon usage rather than time of initial sale.

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
DECEMBER 31, 1997 AND 1998

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash and Cash Equivalents

Cash equivalents consist of highly liquid investments with a maturity of less than three months when purchased.

Property and Equipment

Depreciation of property and equipment is computed using the straight-line method over the estimated useful lives of the respective assets, which range from one to fifteen years. Depreciation of IRUs is computed using the straight-line method over the lease term. Amortization of leasehold improvements is computed using the straight-line method over the lesser of the lease term or estimated useful lives of the improvements.

Internal-use Software

The Company capitalizes certain software development costs for internal use. For the years ended December 31, 1997 and 1998, the Company incurred approximately \$897,000 and \$1,925,000 respectively, of such costs and has included them in Property, Equipment and Leasehold Improvements. The capitalized software are amortized on a straight-line basis over the estimated useful life, generally two years. Prior to 1997, such costs were immaterial.

Intangible Assets

Intangible assets represent the excess of cost of acquired businesses over the underlying fair value of the tangible net assets acquired. Intangible assets are amortized on a straight-line basis over their estimated period of benefit, generally 5 - 20 years. The carrying value of goodwill is periodically reviewed for impairment whenever events or changes in circumstances indicate that it may not be recoverable.

Long-Lived Assets

The Company's policy is to record long-lived assets at cost. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of," these assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be recoverable. Furthermore, the assets are evaluated for continuing value and proper useful lives by comparison to expected future cash projections. The Company amortizes these costs over the expected useful life of the related asset. As of December 31, 1998 the Company does not believe any impairment exists with its long-lived assets.

Income Taxes

Prior to 1996, the Company was an S-Corporation for federal and state income tax purposes and, as a result, the earnings of the Company were treated as taxable income of the shareholders. During 1996, the Company changed its tax status to a C-Corporation.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
DECEMBER 31, 1997 AND 1998

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to be applied to taxable income in the year in which those temporary differences are expected to be recovered or settled. Deferred income taxes are not provided on undistributed earnings of foreign subsidiaries since such earnings are currently expected to be permanently reinvested outside the United States.

Stock-Based Compensation

SFAS No. 123 "Accounting for Stock-Based Compensation," encourages, but does not require, companies to record compensation cost for stock-based employee compensation plans at fair value. The Company has chosen to continue to account for stock-based compensation awards to employees and directors using the intrinsic value method prescribed in Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Accordingly, compensation cost for stock options awarded to employees and directors is measured as the excess, if any, of the fair value of the Company's stock at the date of grant over the amount an employee or director must pay to acquire the stock.

The Company accounts for stock-based compensation awards to outside consultants and affiliates based on the fair value of such awards. Accordingly, compensation costs for stock option awards to outside consultants and affiliates is measured at the date of grant based on the fair value of the award using the Black-Scholes option pricing model (See Note 14).

New Accounting Pronouncements

These standards increase disclosure only and have no impact on the Company's financial position or results of operations. These standards have been adopted in 1998 and have been reflected in the financial statements and notes for the year ended December 31, 1998.

In March 1998, the American Institute of Certified Public Accountants (the "AICPA") issued Statement of Position ("SOP") 98-1, "Accounting for Costs of Computer Software Developed or Obtained for Internal Use". SOP 98-1 provides guidance on accounting for the costs of computer software developed or obtained for internal use software, dividing the development into three stages: (1) the preliminary project stage, during which conceptual formulation and evaluation of alternatives takes place, (2) the application development stage, during which design, coding, installation and testing takes place and (3) the operations stage during which training and maintenance takes place. Costs incurred during the application development stage are capitalized, all other costs are expensed as incurred. SOP 98-1 is effective for financial statements for fiscal years beginning after December 15, 1998. The Company has reviewed the provisions of SOP 98-1 and does not believe adoption of this standard will have a material effect on its results of operations, financial position or cash flows.

In April 1998, the AICPA issued SOP 98-5, "Reporting on the Costs of Start-up Activities." SOP 98-5 requires that all non-governmental entities expense the costs of start-up activities, including organization costs, as those costs are incurred. SOP 98-5 is effective for financial statements for fiscal years beginning after December 15, 1998. The Company has reviewed the provisions of SOP 98-5 and does not believe adoption of this standard will have a material effect on its results of operations.

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
DECEMBER 31, 1997 AND 1998

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Foreign Currency Exchange

The financial statements of all foreign subsidiaries were prepared in their respective local currencies and translated into U.S. dollars based on the current exchange rate at the end of the period for the balance sheets and an average rate for the period on the statements of operations. Translation adjustments generally are reflected as foreign currency translation adjustments in the statement of stockholders' equity and, accordingly, have no effect on net income. Foreign currency transaction adjustments are reflected in the statements of operations.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year's presentation.

Unaudited Pro Forma Information

The Company's historical capital structure is not indicative of its prospective structure due to the automatic conversion of all shares of Series A Redeemable Convertible Preferred Stock into common stock concurrent with the closing of the Company's anticipated initial public offering ("IPO") (see Note 12 for conversion terms).

The unaudited pro forma consolidated balance sheet as of December 31, 1998, reflects the conversion of 140,000 shares of the Series A Redeemable Convertible Preferred Stock into approximately 3,554,000 shares of common stock.

Pro forma loss per share is computed using the weighted average number of common shares outstanding during the period assuming the conversion of convertible preferred stock issued into common stock as of the date of issuance.

Per Share Data

During 1997, SFAS No. 128 "Earnings per Share" was issued and became effective for the Company's December 31, 1997 financial statements. SFAS No. 128 establishes new standards for computing and presenting earnings per share ("EPS"). The new standard requires the presentation of basic EPS and diluted EPS. Basic EPS is calculated by dividing income available to common shareholders by the weighted average number of shares of common stock outstanding during the period. Diluted EPS is calculated by dividing income available to common shareholders by the weighted average number of common shares outstanding adjusted to reflect potentially dilutive securities. All outstanding options, warrants and convertible preferred shares would be antidilutive. Therefore, their effect has been excluded from the calculation of diluted EPS.

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
DECEMBER 31, 1997 AND 1998

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The following is the reconciliation of net loss per share as of December 31,

	<u>1996</u>	<u>1997</u>	<u>1998</u>
Numerator			
Net loss	\$(8,312,000)	\$(30,128,000)	\$(68,944,000)
Less dividends on preferred stock	(281,000)	(879,000)	—
Less accretion of preferred stock	(15,000)	(91,000)	(93,000)
Loss available to common shareholders	<u>\$(8,608,000)</u>	<u>\$(31,098,000)</u>	<u>\$(69,037,000)</u>
Denominator			
Weighted Average shares outstanding	<u>20,778,000</u>	<u>20,778,000</u>	<u>20,846,000</u>

3. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Financial Accounting Standards Board has issued SFAS No. 107 entitled "Disclosures about Fair Value of Financial Instruments," which requires entities to disclose information about the fair values of their financial instruments.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value.

Long-Term Debt

The carrying amount of the Company's current portion of long-term borrowings approximates fair value. The fair value of the Company's long-term debt, including current portions, is determined based on market prices for similar debt instruments or on the current rates offered to the Company for debt with similar maturities. As of December 31, 1998, the Company's senior notes were made up of the 13½% Senior Notes due 2007 (the "1997 Notes") issued July 1, 1997, and the 11% Senior Discount Notes due 2008 (the "1998 Notes") issued February 12, 1998 (together the "Senior Notes"). The fair value of the 1997 Notes and the 1998 Notes, based upon quotes from securities dealers, were \$157,325,000 and \$151,500,000, respectively.

4. DEBT AND EQUITY SECURITIES

The Company accounts for short-term investments in accordance with SFAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities." Short-term investments have an original maturity of more than three months and a remaining maturity of less than one year. These investments are stated at cost as it is the intent of the Company to hold these securities until maturity. The funds are invested in compliance with the Company's bond indentures which restrict the type, quality and maturity of

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
DECEMBER 31, 1997 AND 1998

4. DEBT AND EQUITY SECURITIES (Continued)

investments. The table below discloses the fair value of held-to-maturity securities as of December 31, 1998.

	Aggregate Amortized Cost Basis	Aggregate Fair Value December 31, 1998	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses
U.S. treasury notes	\$ 38,949,000	\$ 39,246,000	\$365,000	\$(68,000)
Government agency notes	54,438,000	54,611,000	173,000	—
Commercial paper	14,914,000	14,960,000	47,000	(1,000)
Other debt securities	19,976,000	19,975,000	—	(1,000)
	<u>\$128,277,000</u>	<u>\$128,792,000</u>	<u>\$585,000</u>	<u>\$(70,000)</u>
Included in cash and cash equivalents . . .	\$ 66,467,000			
Included in marketable securities	21,343,000			
Included in current portion of restricted cash	9,590,000			
Included in non-current restricted cash . .	30,877,000			
	<u>\$128,277,000</u>			

5. PROPERTY, EQUIPMENT AND LEASEHOLD IMPROVEMENTS

Property, equipment and leasehold improvements consist of the following:

	December 31,	
	1997	1998
Equipment	\$23,403,000	\$102,696,000
Computer software	2,263,000	9,257,000
Furniture and fixture	634,000	4,841,000
Leasehold improvements	1,503,000	2,873,000
	<u>27,803,000</u>	<u>119,667,000</u>
Less accumulated depreciation and amortization	(3,690,000)	(12,418,000)
Property, equipment and leasehold improvements, net	<u>\$24,113,000</u>	<u>\$107,249,000</u>

Depreciation expense for the years ended December 31, 1996, 1997 and 1998, was \$1,008,000, \$2,297,000 and \$8,728,000, respectively.

6. TERRITORIAL RIGHTS

In September 1994, the Company entered into a joint venture with Europhone International Ltd. ("EI") to jointly market Destia's services in the United Kingdom. EI engaged in sales and marketing, while Destia provided network support, billing and transmission services.

In connection with the modification of this joint marketing arrangement, which occurred in June 1996, EI granted the Company the right to compete with EI in exchange for forgiveness of the net receivable due

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
DECEMBER 31, 1997 AND 1998

6. TERRITORIAL RIGHTS (Continued)

to the Company of \$2,000,000. The Company charged this to operations in 1996 as an expense of the joint venture.

7. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities consist primarily of accrued carrier cost of \$1.658.000 and \$17,408,000 for 1997 and 1998, respectively.

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
DECEMBER 31, 1997 AND 1998

8. FOREIGN OPERATIONS AND CONCENTRATIONS

Foreign Operations

The Company's trade accounts receivable are subject to credit risk, although the customer base is diversified due its size and geographic dispersion. The Company does not require collateral or other security to support its receivables. The Company closely monitors extensions of credit and performs ongoing evaluations of customer accounts to control the exposure to bad debt risks. Bad debt expense is recorded quarterly and is based on the Company's historical bad debt write-off experience. Actual write-offs are charged against the bad debt allowance as certain accounts are determined to be uncollectable. The Company's total sales, operating income (before interest, foreign currency exchange and other income) and identifiable assets by geographical area for the years ended and as of December 31, 1996, 1997 and 1998 are as follows:

	<u>United Kingdom</u>	<u>North America</u>	<u>Belgium</u>	<u>Other Europe</u>	<u>Consolidated</u>
1996					
Revenues	\$ 15,477,000	\$ 18,185,000	\$ 9,038,000	\$ 2,403,000	\$ 45,103,000
Operating loss	\$ (2,473,000)	\$ (3,855,000)	\$(1,472,000)	\$ (349,000)	\$ (8,149,000)
Corporate expenses					(163,000)
					<u>\$ (8,312,000)</u>
Accounts receivable	\$ 2,283,000	\$ 3,718,000	\$ 1,488,000	\$ 457,000	\$ 7,946,000
Property, equipment and leasehold improvements . .	1,423,000	4,001,000	847,000	201,000	6,472,000
Corporate assets					8,337,000
					<u>\$ 22,755,000</u>
1997					
Revenues	\$ 18,363,000	\$ 48,899,000	\$ 7,981,000	\$ 7,760,000	\$ 83,003,000
Operating loss	\$ (2,966,000)	\$(18,213,000)	\$ (374,000)	\$ (664,000)	\$(22,217,000)
Corporate expenses					(7,911,000)
					<u>\$(30,128,000)</u>
Accounts receivable	\$ 5,252,000	\$ 9,034,000	\$ 1,250,000	\$ 1,260,000	\$ 16,796,000
Property, equipment and leasehold improvements . .	6,731,000	16,515,000	463,000	405,000	24,114,000
Corporate assets					137,095,000
					<u>\$178,005,000</u>
1998					
Revenues	\$ 55,991,000	\$116,645,000	\$11,515,000	\$ 9,586,000	\$193,737,000
Operating income(loss)	\$(16,474,000)	\$(17,138,000)	\$ 905,000	\$ (6,062,000)	\$(38,769,000)
Corporate expenses					(30,175,000)
					<u>\$(68,944,000)</u>
Accounts receivable	\$ 11,367,000	\$ 19,096,000	\$ 1,430,000	\$ 1,458,000	\$ 33,351,000
Property, equipment and leasehold improvements . .	15,899,000	74,700,000	3,673,000	12,977,000	107,249,000
Corporate assets					247,608,000
					<u>\$388,208,000</u>

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
DECEMBER 31, 1997 AND 1998

8. FOREIGN OPERATIONS AND CONCENTRATIONS (Continued)

The revenues of EI accounted for \$14.2 million or 32% in 1996. The relationship was terminated in December 1996.

9. BORROWINGS

At December 31, 1997, the Company was obligated under the following debt agreements:

	<u>Current</u>	<u>Long-term</u>	<u>Total</u>
Long-term debt:			
NTFC note (a)	\$1,633,000	\$ 5,522,000	\$ 7,155,000
Notes Payable (b)	196,000	135,000	331,000
1997 Notes (c)	—	149,680,000	149,680,000
	<u>\$1,829,000</u>	<u>\$155,337,000</u>	<u>\$157,166,000</u>

At December 31, 1998, the Company was obligated under the following debt agreements:

	<u>Current</u>	<u>Long-term</u>	<u>Total</u>
Long-term debt:			
NTFC note (a)	\$ 4,708,000	\$ 16,434,000	\$ 21,142,000
Notes payable (b)	11,524,000	20,945,000	32,469,000
1997 Notes (c)	—	150,240,000	150,240,000
1998 Notes (d)	—	192,936,000	192,936,000
	<u>\$16,232,000</u>	<u>\$380,555,000</u>	<u>\$396,787,000</u>

- (a) On May 28, 1996, Destia entered into a credit facility with NTFC, which the terms and amount of have been amended and increased, respectively, on several occasions. On January 28, 1998, the NTFC credit facility was amended and restated in its entirety in order to effect various amendments and increase the amount of NTFC's commitment thereunder (such credit facility, as amended and restated, is referred to herein as the "NTFC Facility"). The NTFC Facility provides for borrowings by Destia and its subsidiaries to fund certain equipment acquisition costs and related expenses. The NTFC Facility provides for an aggregate commitment of NTFC of \$24.0 million pursuant to three tranches of \$2.0 million, \$3.0 million and \$19.0 million. Loans borrowed under each tranche of the NTFC Facility amortize in equal monthly installments over a five year period ending on July 1, 2001, April 1, 2002 and January 1, 2003, respectively. Loans under the NTFC Facility accrue interest at an interest rate equal to the 90-day commercial paper rate plus 395 basis points, subject to certain quarterly adjustments depending upon financial performance. All of the equipment purchased with the proceeds of the NTFC Facility has been pledged to NTFC. The NTFC Facility requires Destia to maintain certain Debt Service Coverage Ratios, EBITDA (each defined in the NTFC Facility) and minimum cash balances. Destia was in compliance with these covenants at December 31, 1997. Destia obtained a waiver of these covenants so that it was in compliance at December 31, 1998.
- (b) At December 31, 1998 the Company has seven notes payable related to the purchase of cable lines and acquisitions. These notes bear interest at rates ranging from 5% to 12%, and have maturity dates from April 2001 to November 2008.

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
DECEMBER 31, 1997 AND 1998

9. BORROWINGS (Continued)

At December 31, 1997 the Company has six notes payable related to the purchase of cable lines. Three of these notes bear interest at 12%, and matures through September 1998. The remaining three notes bear interest at LIBOR plus 5%, and mature on June 30, 2001. These notes have quarterly principal and interest payments ranging from \$5,849 to \$30,291.

- (c) Destia completed on July 1, 1997 the offering (the "1997 Unit Offering") of 155,000 units (each a "Unit"), each Unit consisting of one 1997 Note and one warrant (each a "Warrant") to purchase 8.485 shares of common stock of Destia. The Units were sold for an aggregate gross purchase price of \$155.0 million. On December 5, 1997, the Company consummated an offer to exchange the notes issued in the 1997 Unit Offering for \$155.0 million of notes that had been registered under the Securities Exchange Act of 1933.

The 1997 Notes are unsecured unsubordinated obligations of Destia, limited to \$155.0 million aggregate principal amount at maturity, and mature on July 15, 2007. Interest on the 1997 Notes accrues at the rate of 13½% per annum from the most recent interest payment date on which interest has been paid or provided for, payable semiannually (to holders of record at the close of business on the January 1 or July 1 immediately preceding the interest payment date) on January 15 and July 15 of each year, commencing January 15, 1998. At the closing of the 1997 Unit Offering, Destia used \$57.4 million of the net proceeds of the 1997 Unit Offering to purchase restricted cash and securities, which were pledged as security for the payment of interest on the principal of the 1997 Notes. Proceeds from the restricted cash and securities are being used by Destia to make interest payments on the 1997 Notes through July 15, 2000. The restricted cash and securities are being held by a trustee pending disbursement.

- (d) During February 1998, the Company issued the 1998 Notes. The 1998 Notes are unsecured unsubordinated obligations of the Company, initially limited to \$300.0 million aggregate principal amount at maturity, and mature on February 15, 2008. Although for Federal income tax purposes a significant amount of original issue discount, taxable as ordinary income, was recognized by the holders as such discount accrues from the closing date, no interest is payable on the 1998 Notes prior to February 15, 2003. Interest on the 1998 Notes will accrue at 11.0% from February 15, 2003 or from the most recent Interest Payment Date to which interest has been paid or provided for, payable semiannually (to holders of record at the close of business on the February 1 or August 1 immediately preceding the Interest Payment Date) on February 15 and August 15 of each year, commencing August 15, 2003.

Maturities of long-term debt (excluding the accretion of the 1998 Notes) over the next five years are as follows:

1999	\$ 16,232,000
2000	14,567,000
2001	10,808,000
2002	4,837,000
2003 and thereafter	350,343,000
Total	<u>\$396,787,000</u>

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
DECEMBER 31, 1997 AND 1998

10. TAXES

As a telephone carrier and reseller doing business in the U.S., the Company is required to file annual telephone and transmission tax returns in accordance with state tax laws. These returns include taxes on net worth, gross sales and gross profit. In addition, each type of tax requires an additional tax surcharge. The Company also remits federal and state excise taxes and other state and local sales taxes.

As of December 31, 1997 and 1998, the Company had a net operating loss carryforward of approximately \$36,000,000 and \$80,000,000, respectively, which is available to reduce its future taxable income and expires at various dates through 2012. A full valuation allowance of approximately \$14,000,000 and \$31,000,000, respectively, has been established against the deferred tax assets due to the uncertainties surrounding the utilization of the carryforward. There are no other significant timing differences.

A value added tax "VAT" is a tax charged on goods and services that is designed to be borne by the ultimate end user of the goods and services. Pursuant to the Sixth European Commission VAT Directive adopted in 1977 ("VAT Directive"), providers of telecommunications services in the European Union (the EU) are liable for VAT in the EU member state where the provider of the services is established. The provider, in turn, charges VAT to its customers at the rate prevailing in the provider's country of establishment. To date, the collection of VAT by Destia does not appear to have a material adverse effect on its ability to attract or retain customers and the collection of VAT has not required Destia to reduce its prices to remain competitive.

Destia's non-U.S. subsidiaries file separate tax returns and provide for taxes accordingly.

11. STOCKHOLDERS' EQUITY (DEFICIT)

In February 1998, the New York corporation "Econophone, Inc." was merged into its wholly-owned subsidiary named "Econophone, Inc." (now known as Destia Communications, Inc.) which had been incorporated in the State of Delaware for the sole purpose of changing the state of incorporation of the Company. The Delaware corporation was the surviving entity in the merger. In connection with the foregoing, the par value of the Company's common stock was changed to \$.01 per share of voting and non-voting common stock.

On July 17, 1998, the Company acquired the minority interest in Telco that it did not already own. In connection with such acquisition the Company converted options to acquire Telco shares held by Telco employees into grants of non-voting restricted shares of the Company's common stock. The shares carry the same rights as the voting common stock, other than voting rights.

On November 1, 1996, the Company's Articles of Incorporation were amended to change all of the authorized shares of common stock and non-voting common stock from no par value per share to \$.0001 par value per share, to increase the number of shares of authorized common stock from 400 shares to 29,250,000 shares, to increase the number of authorized shares of non-voting common stock from 19,600 shares to 500,000 shares and to authorize the issuance of 250,000 shares of preferred stock. Additionally, the Company effected a recapitalization whereby the outstanding shares of common stock were converted on a 73,125:1 basis.

All information contained in the accompanying financial statements and footnotes have been retroactively restated to give effect to these transactions.

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
DECEMBER 31, 1997 AND 1998

11. STOCKHOLDERS' EQUITY (DEFICIT) (Continued)

Included within additional paid in capital, is \$5.6 million attributable to the Warrants, which represents the portion of the issue price for the Units attributable to the fair value of the Warrants. Such amount has been recognized as a discount on the 1997 Notes and will be amortized over the term of the 1997 Notes. Each Warrant may be exercised for 8.167 shares of common stock at an exercise price of \$.01 per share. The Warrants are exercisable for 1,315,148 shares of common stock, in the aggregate. The fair value of the shares issuable upon exercise of the Warrants was determined to be \$4.26 per share. Among the factors considered in making such determinations were the history of the prospects for the industry in which Destia competes, an assessment of Destia's management, the present operations of Destia, the historical results of operations of Destia and the trend of its revenues and earnings, the prospects for future earnings of Destia, the general condition of the securities markets at the time of the 1997 Unit Offering and the prices of similar securities of generally comparable companies. The Warrants expire on June 30, 2007.

12. SERIES A REDEEMABLE CONVERTIBLE PREFERRED STOCK

On November 1, 1996, the Company entered into a Securities Purchase Agreement (the "Agreement") with Princes Gate Investors II, L.P., an affiliate of Morgan Stanley & Co., Incorporated, whereby it authorized and issued 140,000 shares of \$.01 par value Redeemable Convertible Preferred Stock (the "Series A Preferred") for a purchase price of approximately \$13,061,000, net of issuance costs. The stated redemption value on the preferred stock is \$14,000,000 (or \$100 per share). The Series A Preferred is senior to all other capital stock of the Company.

The Series A Preferred accrue monthly cumulative dividends on each outstanding share at a rate of \$1.00 per month. The accrued and unpaid dividends compound monthly at a rate of 12% per year. The dividends began to accrue and compound interest from the issuance date of the preferred stock and ceased to accrue on July 1, 1997, when the Senior Notes were issued.

The mandatory redemption of the Series A Preferred is October 31, 2006. The redemption shall be in cash.

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
DECEMBER 31, 1997 AND 1998

12. SERIES A REDEEMABLE CONVERTIBLE PREFERRED STOCK (Continued)

Each holder of the Series A Preferred shall have the right, at the option of the holder, to convert any of its shares of Series A Preferred into a number of fully paid and nonassessable shares of common stock. At any time, any holder of Series A Preferred Stock may convert all or any portion thereof into common stock of Destia. As of December 31, 1997 and 1998, the shares of Series A Preferred Stock outstanding were convertible into 3,553,821 shares of common stock and would convert automatically upon the Company closing an initial public offering of common stock. The number of shares of common stock that each share of Series A Preferred Stock is convertible into is equal to the number of shares of common stock outstanding on November 1, 1996 (on a diluted basis), which was 22,564,000, multiplied by a fraction (i) the numerator of which is equal to the stated value with respect to the shares of Series A Preferred Stock being so converted, plus any dividends accrued thereon, and (ii) the denominator of which is equal to \$100.0 million plus the number of dollars received by Destia since November 1, 1996 from the exercise of specified options or warrants.

13. RELATED PARTY TRANSACTIONS

The Company has notes payable due to various related parties. These notes are unsecured, and accrue interest at annual rates ranging from 9% to 18%. These notes are demand obligations. (See Note 17 for a discussion of the repayment of certain indebtedness).

The Company has an interest bearing note receivable at December 31, 1997 and 1998 for approximately \$215,000 and \$230,000, respectively, from a related party.

The sister of Alfred West owns a 28% interest in Destia's Swiss subsidiary, Econophone Services GmbH. (See Note 17 for a discussion of the Company's acquisition of such interest)

14. STOCK-BASED COMPENSATION PLANS

On October 31, 1996, the Board of Directors adopted the Destia Communications, Inc. 1996 Flexible Incentive Plan (the "1996 Plan") and an Incentive Stock Option Agreement with the then Chief Operating Officer and Chief Financial Officer of the Company. The Company accounts for awards granted to employees and directors under APB No. 25, under which no compensation cost has been recognized for stock options granted. Had compensation cost for these stock options been determined consistent with SFAS No. 123, the Company's net income and earnings per share would have been reduced to the following pro forma amounts:

	<u>1996</u>	<u>1997</u>	<u>1998</u>
Net Loss:			
Available to Common Shareholders . . .	\$(8,608,000)	\$(31,098,000)	\$(69,037,000)
Pro Forma	(9,103,000)	(31,889,000)	(70,737,000)
Basic EPS:			
As Reported	\$ (0.41)	\$ (1.50)	\$ (3.31)
Pro Forma	\$ (0.44)	\$ (1.53)	\$ (3.39)

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
DECEMBER 31, 1997 AND 1998

14. STOCK-BASED COMPENSATION PLANS (Continued)

The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts since the Company anticipates additional awards in the future.

Under the 1996 Plan, the Company granted 20,778 options to outside consultants. All transactions with individuals other than those considered employees, as set forth within the scope of APB No. 25, must be accounted for under the provisions of SFAS No. 123. Under SFAS No. 123, the fair value of the options granted to the consultants as of the date of grant using the Black-Scholes pricing model is \$33,019. The NQSOs (as hereinafter defined) were granted to the consultants for terms of up to ten years and are exercisable in whole or in part at stated times from the date of grant up to three years from the date of grant. The 10,389 options granted to consultants during 1996 and the 10,389 options granted to consultants during 1998 have an exercise price of \$2.41 and \$4.81, respectively. As of December 31, 1997 and 1998, 3,463 and 12,121 of the options granted to the consultants were exercisable, respectively, and the expense recognized in 1996, 1997 and 1998 relating to these options was \$496, \$2,976 and \$9,666, respectively.

The 1996 Plan as amended authorizes the granting of awards, the exercise of which would allow up to an aggregate of 4,600,000 shares of the Company's common stock to be acquired by the holders of said awards. The awards can take the form of Incentive Stock Options ("ISOs"), Non-qualified Stock Options ("NQSOs"), Stock Appreciation Rights ("SARs"), Restricted Stock and Unrestricted Stock. The SARs may be awarded either in tandem with options or on a stand-alone basis. Awards may be granted to key employees, directors and consultants. ISOs and NQSOs are granted in terms not to exceed ten years and become exercisable as set forth when the award is granted. Options may be exercised in whole or in part. The exercise price of the ISOs is the market price of the Company's common stock on the date of grant. The exercise price of NQSOs shall never be less than the par value of the Company's common stock. Any plan participant who is granted ISOs and possesses more than 10% of the voting rights of the Company's outstanding common stock must be granted an option price with at least 110% of the fair market value on the date of grant and the option must be exercised within five years from the date of grant. Under the Company's 1996 Plan, ISOs and NQSOs have been granted to key employees and directors for terms of up to ten years, at various exercise prices and are exercisable in whole or in part at stated times from the date of grant up to three years from the date of grant. At December 31, 1997 and 1998, 1,152,418 and 2,239,583 options respectively, were exercisable under the Company's 1996 Plan.

Option activity during 1997 and 1998 is as follows:

	1997		1998	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	2,707,935	\$ 2.41	3,014,358	\$2.64
Granted	316,812	4.81	1,598,429	6.13
Cancelled	(10,389)	2.41	(175,672)	2.93
Outstanding at end of year	3,014,358	2.64	4,437,115	3.85
Exercisable at end of year	1,152,418	2.41	2,239,583	2.74
Weighted average fair value of options granted		1.84		2.36

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
DECEMBER 31, 1997 AND 1998

14. STOCK-BASED COMPENSATION PLANS (Continued)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants in 1997 and 1998: risk-free interest rate of 6.23% and 5.43% for 1997 and 1998; expected life of three years for 1997 and 1998; expected volatility of 47% for 1997 and 66% for 1998 and expected dividend yield of zero percent for 1997 and 1998.

The following table summarizes information with respect to stock options outstanding at December 31, 1998:

Exercise Price	Options Outstanding		Weighted Average Exercise Price	Option Exercisable	
	Number Outstanding at December 31, 1998	Weighted Average Remaining Contractual Life		Number Exercisable at December 31, 1998	Weighted Average Exercise Price
\$2.41—\$4.81	3,568,062	8.03	\$3.05	2,239,583	\$2.64
\$6.50—\$7.22	869,053	9.28	\$7.14	—	—

15. COMMITMENTS AND CONTINGENCIES

The Company has various lease agreements for offices, automobiles and other property. Future minimum annual lease payments under the Company's operating and capital leases with initial or remaining terms of one year or more at December 31, 1998 are as follows:

	Operating Leases	Capital Leases
1999.....	\$ 5,389,000	\$154,000
2000.....	4,140,000	91,000
2001.....	3,529,000	67,000
2002.....	2,988,000	35,000
2003 and thereafter.....	6,919,000	—
Total minimum lease payments	<u>\$22,965,000</u>	<u>\$347,000</u>

The rent expense for the years ended December 31, 1996, 1997 and 1998 was approximately \$394,000, \$1,378,000 and \$2,824,000, respectively.

As of December 31, 1998, The Company has entered into employment agreements with certain officers which expire by December 31, 1999. The aggregate commitment for future compensation under these agreements is approximately \$1,350,000. These officers are also eligible for annual bonuses based on performance. See Note 17 for a discussion regarding employment agreements entered into after such date.

Long-Term Lease Agreement

On November 17, 1998, Destia reached an agreement with Frontier Communications ("Frontier") to acquire a 20-year IRU to use portions of its U.S. fiber optic network. The Company expects to begin using some of Frontier's network by July 1999. Additionally, management expects that Frontier's fiber optic network will be fully operational by the end of 1999. A portion of the acquisition price was paid on

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
DECEMBER 31, 1997 AND 1998

15. COMMITMENTS AND CONTINGENCIES (Continued)

November 17, 1998. The balance of the obligation will be discharged over the next 36 months based upon the terms and conditions of the agreement. Beginning in June 1999, Frontier shall have the right to purchase on a monthly basis up to a cumulative average of one million dollars in Destia services that will be offset against the remaining obligation in lieu of additional cash payments. At the end of the 36-month period the balance remaining will be settled with a cash payment. The acquisition price will be amortized over 20 years and will commence at the date that the network becomes substantially operational. The Company's total commitments are approximately \$42.3 million in the aggregate for the 20-year IRU from Frontier and for the purchase of a transatlantic IRU.

16. ACQUISITIONS

VoiceNet Acquisition

A definitive agreement to acquire VoiceNet was entered into on January 28, 1998. The closing of the VoiceNet Acquisition occurred on February 12, 1998. The initial purchase price for VoiceNet was \$21.0 million and was paid out of cash on hand. The sellers of VoiceNet also are entitled to receive an earn-out based upon the revenue growth of the VoiceNet business for a period of up to one year following the closing of the acquisition.

VoiceNet provides travellers and other callers with calling card services, which are advertised primarily in in-flight magazines. Destia has provided substantially all of VoiceNet's transmission, billing and customer service functions since April 1996.

Telco Minority Interest Acquisition

In the United Kingdom, the majority of Destia's sales are made through Telco Global Communications ("Telco"), its majority owned subsidiary that was established during the fourth quarter of 1996. Telco's revenues are derived primarily from international and domestic long distance services and the sale of prepaid cards. On July 17, 1998, the Company acquired the 30% minority interest in Telco it did not already own in exchange for approximately \$14.0 million in cash, payable by the Company in quarterly installments, together with interest at a rate of 8.0% per annum, over approximately three years. The entire purchase price is classified as goodwill, which will be amortized over 20 years. In connection with such acquisition, (i) Telco obtained ownership rights with respect to certain proprietary software used in Telco's business and (ii) the Company converted options to acquire Telco shares held by Telco employees into grants of non-voting restricted shares of the Company's common stock.

Other Acquisitions

During November 1998, the Company completed two small acquisitions. It acquired a controlling interest in America First Ltd. ("America First"), a prepaid card distributor in the United Kingdom for approximately \$5.5 million. The majority of the purchase price was recorded as goodwill and will be amortized over 20 years. The Company also acquired the customer list of a long distance reseller, also located in the United Kingdom. The purchase price was allocated to the customer base and will be amortized over 5 years.

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
DECEMBER 31, 1997 AND 1998

17. SUBSEQUENT EVENTS (UNAUDITED)

Initial Public Offering

The Company has announced that it had filed a registration statement with the Securities and Exchange Commission for an initial public offering of its common stock, for 6,500,000 shares at \$10.00 per share excluding over allotment.

Stock Split

The financial statements retroactively reflect the 1.04 for 1 stock split which occurred in connection with the above offering.

Acquisition of Minority Interest in Subsidiary

On March 30, 1999, the Company acquired the 28% minority interest in Econophone Services GmbH (Switzerland). The entire purchase price is classified as goodwill, which is amortized over 20 years.

Employment Agreements and Arrangements

For a discussion on recent employment agreements and arrangements with certain officers of the Company, see "Management—Employment Agreements and Arrangements" in the Registration Statement.

Repayment of Certain Indebtedness

The related party notes described in Note 13 have been repaid in full.

Capital Stock Increases

Subsequent to year end, the Board of Directors approved a change in the authorized shares of common stock from 29,250,000 to 72,000,000 shares and in the preferred stock from 250,000 to 2,500,000 shares. In addition, the Company increased the number of authorized shares reserved for the issuance of stock options under the 1996 Plan from 4,600,000 to 5,500,000 shares.

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, DC 20529

FORM 10-Q

(MARK ONE)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 1999
or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the transition period from to

Commission File Number 333-33117

DESTIA COMMUNICATIONS, INC.

(formerly Econophone, Inc.)

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

11-3132722
(IRS Employer
Identification No.)

95 Route 17 South, 3rd Floor, Paramus, N.J.
(Address of principal executive offices)

07652
(Zip Code)

(201) 226-4500

Registrant's telephone number, including area code

45 Broadway, 30th Floor, New York, N.Y.
(Former address of principal executive offices)

10006
(Zip Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES ☒ NO ☐

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

<u>Class</u>	<u>Outstanding at July 31, 1999</u>
Common Stock, \$.01 par value	31,177,012
Non-voting Common Stock, \$.01 par value	103,642

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
1999 SECOND QUARTER REPORT ON FORM 10-Q

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PART I
FINANCIAL INFORMATION

Item 1 Condensed Consolidated Financial Statements and Notes thereto

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands except per share data)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	1998	1999	1998	1999
REVENUES	\$ 48,754	\$ 75,971	\$ 90,414	\$138,590
COST OF SERVICES	35,585	54,367	67,041	98,737
Gross profit	13,169	21,604	23,373	39,853
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	19,272	29,911	34,756	56,526
DEPRECIATION AND AMORTIZATION	2,424	6,915	4,102	12,764
Loss from operations	(8,527)	(15,222)	(15,485)	(29,437)
INTEREST EXPENSE, net	(6,597)	(9,640)	(12,276)	(19,529)
FOREIGN CURRENCY EXCHANGE (LOSS) GAIN, net	(2)	7	114	(37)
OTHER EXPENSE, net	(196)	(356)	(269)	(706)
Net loss	<u>\$ (15,322)</u>	<u>\$ (25,211)</u>	<u>\$ (27,916)</u>	<u>\$ (49,709)</u>
BASIC AND DILUTED LOSS PER SHARE ...	<u>\$ (0.74)</u>	<u>\$ (0.93)</u>	<u>\$ (1.34)</u>	<u>\$ (2.07)</u>
WEIGHTED AVERAGE NUMBER OF BASIC AND DILUTED COMMON SHARES OUTSTANDING	<u>20,778</u>	<u>27,239</u>	<u>20,778</u>	<u>24,028</u>

The accompanying notes to the financial statements are an integral part of these statements.

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands except share data)

	December 31, 1998 (see note)	June 30, 1999 (unaudited)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 118,218	\$ 118,844
Marketable securities	21,343	—
Accounts receivable, net of allowance for doubtful accounts of \$4,086 and \$5,523, respectively	33,351	46,447
Prepaid expenses and other current assets	3,409	6,045
Restricted cash and securities	9,590	9,591
Total current assets	185,911	180,927
PROPERTY, EQUIPMENT AND LEASEHOLD IMPROVEMENTS, net of accumulated depreciation and amortization of \$12,418 and \$21,878 at December 31, 1998 and June 30, 1999, respectively	107,249	132,375
Debt issuance costs	12,244	11,576
Intangibles	49,488	50,809
Other assets	2,439	4,263
Restricted cash and securities	30,877	21,458
Total assets	<u>\$ 388,208</u>	<u>\$ 401,408</u>
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
CURRENT LIABILITIES:		
Accounts payable	\$ 33,352	\$ 34,543
Accrued expenses and other current liabilities	31,131	39,224
Interest accrued on Senior Notes	9,590	9,591
Current maturities of other long-term debt	16,232	9,487
Current maturities of obligations under capital lease	154	590
Current maturities of notes payable — related party	308	—
Deferred revenue	4,739	4,834
Total current liabilities	95,506	98,269
OTHER LONG-TERM DEBT	37,379	25,725
OBLIGATIONS UNDER CAPITAL LEASE	193	946
SENIOR NOTES	343,176	354,066
SERIES A REDEEMABLE CONVERTIBLE PREFERRED STOCK	14,421	—
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY (DEFICIT)		
Voting common stock, par value \$.01; 29,250,000 and 72,000,000 shares authorized at December 31, 1998 and June 30, 1999, respectively; 20,778,321 and 31,119,397 shares issued and outstanding at December 31, 1998 and June 30, 1999, respectively	208	311
Non-voting common stock, par value \$.01; 500,000 shares authorized; 135,890 and 95,331 shares issued and outstanding at December 31, 1998 and June 30, 1999, respectively	1	1
Additional paid-in capital	6,923	81,346
Accumulated other comprehensive loss	(856)	(1,003)
Accumulated deficit	(108,743)	(158,253)
Total stockholders' equity (deficit)	(102,467)	(77,598)
Total liabilities and stockholders' equity (deficit)	<u>\$ 388,208</u>	<u>\$ 401,408</u>

Note: The December 31, 1998 Balance Sheet is derived from audited financial statements.

The accompanying notes to the financial statements are an integral part of these statements.

DESTIA COMMUNICATIONS, INC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Six months ended June 30,	
	1998	1999
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (27,916)	\$(49,709)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	4,102	12,764
Provision for doubtful accounts	3,244	1,437
Accreted interest expense	7,645	10,890
Changes in assets and liabilities:		
Increase in accounts receivable	(15,739)	(13,734)
Increase in prepaid expenses and other current assets	(2,769)	(2,085)
Decrease (increase) in other assets	501	(2,601)
Increase in accounts payable, accrued expenses and other current liabilities	20,646	7,370
Increase in deferred revenue	1,515	95
Net cash used in operating activities	(8,771)	(35,573)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(35,645)	(32,983)
Net cash paid in acquisitions	(20,980)	(2,255)
(Purchase) sale of marketable securities — net	(134,956)	21,343
Net cash used in investing activities	(191,581)	(13,895)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from issuance of common stock	—	59,000
Net proceeds from exercise of stock options	—	532
Proceeds from long-term debt	922	—
Repayments of long-term debt	(984)	(18,399)
Repayments of capital leases	(92)	(149)
Repayments of notes payable — related party	(7)	(308)
Proceeds from senior notes	175,785	—
Payment of debt issuance costs	(7,159)	—
Net cash provided by financing activities	168,465	40,676
Decrease in cash and cash equivalents, (including restricted cash)	(31,887)	(8,792)
Cash and cash equivalents, beginning of period (including restricted cash)	126,629	158,685
Cash and cash equivalents, end of period (including restricted cash)	<u>\$ 94,742</u>	<u>\$149,893</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	\$ 11,710	\$ 11,854
SUPPLEMENTAL DISCLOSURE OF NONCASH ACTIVITIES:		
Accretion of preferred stock	\$ 46	\$ —
Capital leases executed	—	1,338
Acquisition in exchange for common stock	—	675
Conversion of preferred stock into common stock	—	14,421
DETAILS OF ACQUISITIONS:		
Fair value of assets acquired	(1,068)	(1,615)
Goodwill	(20,613)	(2,555)
Liabilities assumed	701	1,915
Net cash paid for acquisitions	<u>\$ (20,980)</u>	<u>\$ (2,255)</u>

The accompanying notes to the financial statements are an integral part of these statements.

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note A — Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Destia Communications, Inc. (formerly Econophone, Inc.) ("Destia" or the "Company") have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted, although management believes that the disclosures herein are adequate to make the information presented not misleading. All significant intercompany balances and transactions have been eliminated in consolidation. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. In the opinion of management, all adjustments (consisting of only normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three-month or six-month period ended June 30, 1999 are not necessarily indicative of the results that may be expected for the year ending December 31, 1999. It is suggested that these financial statements be read in conjunction with Destia's audited annual consolidated financial statements.

Note B — Cash and Cash Equivalents

Cash equivalents consist of highly liquid investments with a maturity of less than three months when purchased.

Note C — Comprehensive Loss

The comprehensive loss for the three months ended June 30, 1998 and 1999 includes the following components:

	Three Months Ended June 30,	
	1998	1999
Net Loss	\$(15,322)	\$(25,211)
Other Comprehensive Income, net of tax:		
Foreign Currency Translation Adjustments	(313)	(282)
Comprehensive Loss	<u>\$ (15,635)</u>	<u>\$ (25,493)</u>

Accumulated other comprehensive loss, (all of which relates to foreign currency translation adjustments) as of December 31, 1998 and June 30, 1999 is as follows:

	December 31, 1998	June 30, 1999
Balance at beginning of period	\$(104)	\$ (856)
Translation Adjustments	(752)	(147)
Balance at end of period	<u>\$ (856)</u>	<u>\$ (1,003)</u>

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(Unaudited)

Note D — Loss Per Share

Loss per share is based on the standards of Statement of Financial Accounting Standards ("SFAS") No. 128 "Earnings per Share", which requires the presentation of basic EPS and diluted EPS. Basic EPS is calculated by dividing income available to common stockholders by the weighted average number of shares of common stock outstanding during the period. Weighted average shares outstanding has been calculated to reflect additional issuances of shares of common stock during the second quarter (including shares of common stock issued as a result of the exercise of warrants or options or the conversion of shares of restricted non-voting common stock or preferred stock). A total of 6,500,000 shares of common stock were issued in connection with Destia's initial public offering in May ("IPO") and, upon consummation of the IPO, shares of preferred stock automatically converted into 3,553,821 shares of common stock. If these shares had been included for the entire second quarter, the weighted average shares outstanding as of June 30, 1999 would have been 31,214,728 shares of common stock. Loss available to common stockholders is calculated as net loss reduced by accretion on preferred stock. Upon the conversion of preferred stock at the IPO, accretion of preferred stock ceased, and the accumulated accretion to date was converted to additional paid-in capital (see Note E). Diluted EPS has not been presented separately since the inclusion of outstanding options and warrants would be antidilutive.

Note E — Accumulated Deficit

The change in the accumulated deficit reflects net loss for the period, which is offset by the reclassification, as a result of the IPO, of the preferred stock accretion, in the amount of approximately \$199,000, from the accumulated deficit to additional paid-in capital. At the IPO, the preferred stock automatically converted to common stock. Prior to May, 1999 accretion of preferred stock was recorded within the accumulated deficit.

Note F — Initial Public Offering

On May 11, 1999, the Company completed an initial public offering of 6,500,000 shares of its common stock, par value \$.01 per share ("Common Stock"), which was priced at \$10.00 per share. The net proceeds to the Company (after deducting underwriter discounts and expenses) were approximately \$59.0 million.

The Company intends to use the net proceeds from the offering to expand its sales and marketing activities and to make capital expenditures, particularly in Europe, as well as to fund working capital and general corporate purposes, including to fund losses. Upon consummation of the IPO, all outstanding shares of Preferred Stock were converted into Common Stock and the following material changes to the Company's certificate of incorporation were effected: (i) the number of authorized shares of Common Stock was increased from 29,250,000 to 72,000,000; (ii) the number of authorized shares of preferred stock was increased from 250,000 to 2,500,000; and (iii) a stock split of 1.04 shares of Common Stock for every 1.0 shares was completed.

Note G — Acquisition of Minority Interest in Subsidiary

On March 30, 1999, the Company acquired the 28% minority interest in Econophone Services GmbH (Switzerland). The entire purchase price is classified as goodwill, which is being amortized over 20 years.

DESTIA COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(Unaudited)

Note H — Geographic Information

In accordance with quarterly reporting requirements of SFAS No. 131 "Disclosures about Segments of an Enterprise and Related Information", the following revenue by segment information is shown for the three-month and six-month periods ended June 30, 1998 and June 30, 1999.

Three Months Ended June 30, 1998 Compared to Three Months Ended June 30, 1999

	Three Months Ended June 30,		
	1998	1999	% Change
	(in thousands)		
<i>Revenue</i>			
North America	\$26,007	\$46,174	78%
United Kingdom	17,849	18,524	4%
Continental Europe	4,898	11,273	130%
Total	<u>\$48,754</u>	<u>\$75,971</u>	<u>56%</u>

Six Months Ended June 30, 1998 Compared to Six Months Ended June 30, 1999

	Six Months Ended June 30,		
	1998	1999	% Change
	(in thousands)		
<i>Revenue</i>			
North America	\$47,045	\$ 86,677	84%
United Kingdom	33,887	31,759	(6)%
Continental Europe	9,482	20,154	113%
Total	<u>\$90,414</u>	<u>\$138,590</u>	<u>53%</u>

Item 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

The following discussion should be read in conjunction with Destia's financial statements and the notes thereto included in the annual report on Form 10-K for the year ended December 31, 1998 filed by Destia pursuant to the requirements of the Securities Exchange Act of 1934. Certain of the matters discussed in this item may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are statements other than historical information or statements of current condition. Some forward-looking statements may be identified by use of terms such as "believes", "anticipates", "intends" or "expects". These forward-looking statements relate to the plans, objectives and expectations of Destia for future operations and its business and the telecommunications industry generally. In light of the risks and uncertainties inherent in all future projections, the inclusion of forward-looking statements in this report should not be regarded as a representation by the Company or any other person that the objectives or plans of the Company will be achieved. The Company's revenues and results of operations are difficult to forecast and could differ materially from those projected in the forward-looking statements as a result of numerous factors affecting one or more of the Company's markets, including the following: (i) inaccuracies in the Company's forecasts of telecommunications traffic or customers; (ii) the rate of expansion of Destia's network and/or customer base; (iii) changes in or developments under laws, regulations, licensing requirements or telecommunications standards; (iv) changes in the availability of transmission facilities; (v) loss of a customer or distributor that provides Destia with significant revenues; (vi) concentration of credit risk; (vii) highly competitive market conditions; (viii) currency fluctuations; (ix) changes in retail or wholesale telecommunications rates; (x) loss of the services of key officers, such as Alfred West, the Chairman and Chief Executive Officer, or Alan L. Levy, the President and Chief Operating Officer; (xi) changes in international settlement rates; (xii) general economic conditions. The foregoing review of important factors should not be construed as exhaustive. The Company undertakes no obligation to release publicly the results of any future revisions it may make to any forward-looking statement to reflect events or circumstances after the date hereof, including the occurrence of unanticipated events.

Overview

Destia is a facilities-based provider of domestic and international telecommunications services in North America and nine countries in Europe. Destia provides its end users with a variety of retail telecommunications services, including international and domestic long distance, calling card and prepaid card services, carrier wholesale transmission services and Internet access.

Destia's objective is to become a leading facilities-based provider of integrated telecommunications services to end users in the largest metropolitan markets in Europe and North America. The key elements of the Company's growth strategy are: (i) focus on high margin end user business; (ii) leverage its existing network and customer support infrastructure; (iii) enhance its network and opportunistically enter new markets; (iv) expand its service offerings; and (v) pursue strategic acquisitions and alliances.

On May 11, 1999, the Company completed an initial public offering of 6,500,000 shares of its common stock, par value \$.01 per share ("Common Stock"), which was priced at \$10.00 per share. The net proceeds to the Company (after deducting underwriter discounts and offering related expenses) were approximately \$59.0 million.

Results of Operations

Three Months Ended June 30, 1998 Compared to Three Months Ended June 30, 1999

	Three Months Ended June 30,		
	1998	1999	% Change
	(in thousands)		
<i>Revenue</i>			
North America	\$26,007	\$46,174	78%
United Kingdom	17,849	18,524	4%
Continental Europe	4,898	11,273	130%
Total	<u>\$48,754</u>	<u>\$75,971</u>	<u>56%</u>
	Three Months Ended June 30,		
	1998	1999	% Change
	(in thousands)		
<i>Billable minutes of use</i>			
North America	121,653	295,735	143%
United Kingdom	80,324	113,649	41%
Continental Europe	9,468	62,657	562%
Total	<u>211,445</u>	<u>472,041</u>	<u>123%</u>

Revenues. Revenues for the three months ended June 30, 1999 increased 56% to \$76.0 million from \$48.8 million for the three months ended June 30, 1998. Billable minutes of use increased 123% to 472.0 million in the current quarter from 211.4 million in the comparable quarter of the prior year. The number of customers serviced by the Company increased 110% to approximately 490,000 at June 30, 1999 from approximately 234,000 at June 30, 1998. The year-to-year revenue increase was primarily attributable to strong retail customer growth in all of our geographic markets. Retail revenues in the second quarter of 1999 increased 91% over the comparable period of 1998. Wholesale revenues in the second quarter of 1999 as compared to the second quarter of 1998 declined significantly and represented approximately 12% of consolidated revenues in the second quarter of 1999, compared to 28% in the second quarter of 1998. The 4% revenue growth rate reported for the U.K. from the second quarter of 1998 to the comparable period of 1999 was negatively impacted by an \$11.0 million reduction in wholesale revenues. The reduction of wholesale revenue was the result of the Company's intentional shift away from certain low margin wholesale customers. The increase in billable minutes as a percentage of overall revenue reflects changes in the Company's product mix, the impact of deregulation in the Company's continental European markets and increased competition in all of the Company's markets.

Gross profit. Gross margins improved from 27.0% in the second quarter of 1998 to 28.4% in the second quarter of 1999 primarily as a result of the growth in retail revenues supported by the continued expansion of Destia's network, increased utilization of owned and leased transmission capacity and improved global routing, all of which contributed to lower per-minute costs. The margin improvement was also partially due to an increase in revenues derived from retail products, which have higher gross margins than wholesale services.

Selling, general and administrative expenses. Selling, general and administrative ("SG&A") expenses for the second quarter of 1999 were \$29.9 million, representing 39.4% of revenue, compared to \$19.3 million in the second quarter of 1998, or 39.5% of revenue. The increase in overall SG&A expense levels was primarily attributable to the increased scale of the Company's operations resulting from the expansion of its business, which contributed to increased staffing-related costs and marketing and promotional expenses. The increase in marketing and promotional expenses was primarily the result of Destia's spending in developing marketing and sales channels in Europe, as well as increased marketing expenditures to grow the retail customer base in North America. SG&A as a percentage of revenue remained virtually the same despite the significant increase in retail revenues which have higher associated selling, marketing and administrative expenses than wholesale revenues.

Depreciation and amortization. Depreciation and amortization expenses increased to \$6.9 million for the three months ended June 30, 1999 from \$2.4 million for the three months ended June 30, 1998. This increase was substantially due to the continuing build-out of the Company's network in North America, the United Kingdom and Continental Europe.

Interest expense and interest income. Interest expense increased to \$11.5 million in the second quarter of 1999 from \$10.4 million in the comparable quarter of the prior year. This increase was primarily attributable to higher interest expense incurred on the 11% Notes issued in February 1998 (the "1998 Notes"), due to the accretion of the principal balance, as well as interest expense incurred related to additional borrowings to finance the cost to acquire switches and other telecommunications equipment and IRUs. Interest income decreased to \$1.9 million in the second quarter of 1999 from \$3.8 million in the second quarter of 1998, primarily due to lower levels of cash and marketable securities.

Net loss. The Company reported a net loss of \$25.2 million for the second quarter of 1999 compared to a net loss of \$15.3 million for the second quarter of 1998. The increase in net loss reflects the increased SG&A expenses associated with the development of the Company's sales and marketing channels and the build out of its customer and network support infrastructure, as well as increased depreciation and amortization expenses.

Results of Operations

Six Months Ended June 30, 1998 Compared to Six Months Ended June 30, 1999

	Six Months Ended June 30,		
	1998	1999	% Change
	(in thousands)		
Revenue			
North America	\$47,045	\$ 86,677	84%
United Kingdom	33,887	31,759	(6)%
Continental Europe	9,482	20,154	113%
Total	<u>\$90.414</u>	<u>\$138.590</u>	<u>53%</u>
	Six Months Ended June 30,		
	1998	1999	% Change
	(in thousands)		
Billable minutes of use			
North America	212,300	524,561	147%
United Kingdom	140,566	208,124	48%
Continental Europe	17,305	100,527	481%
Total	<u>370,171</u>	<u>833,212</u>	<u>125%</u>

Revenues. Revenues for the six months ended June 30, 1999 increased 53% to \$138.6 million from \$90.4 million for the six months ended June 30, 1998. Billable minutes of use increased 125% to 833.2 million in the current six-month period from 370.2 million in the comparable six-month period of the prior year. The year-to-year revenue increase was primarily attributable to strong retail customer growth in all of our geographic markets. Retail revenues in the first six months of 1999 increased 93% over the prior year six-month period. Wholesale revenues in the first six months of 1999 as compared to the first six months of 1998 declined significantly over this period and represented approximately 10% of consolidated revenues in the first half of 1999 compared to 29% in the first half of 1998. The increase in billable minutes as a percentage of overall revenue reflects changes in the Company's product mix, the impact of deregulation in the Company's continental European markets and increased competition in all of the Company's markets.

Gross profit. The gross profit margin of 28.8% reported for the six months ended June 30, 1999 increased 2.9% from the 25.9% achieved in the six months ended June 30, 1998 as a result of the growth in retail revenues supported by the continued expansion of Destia's network, increased utilization of owned and

leased transmission capacity and improved global routing, all of which contributed to lower per-minute costs. The margin improvement was also partially due to an increase in revenues derived from retail products, which have higher gross margins than wholesale services.

Selling, general and administrative expenses. SG&A expenses increased 63% from \$34.8 million for the first six months of 1998 to \$56.5 million for the first six months of 1999. SG&A expenses as a percentage of revenues increased to 40.8% in the 1999 six-month period from 38.4% in the comparable period of the prior year. This increase was primarily attributable both to an increase in retail revenues (which have higher associated selling, marketing and administrative expenses) as a percentage of overall revenues and to the increased scale of the Company's operations resulting from the expansion of its business, which contributed to increased staffing-related costs and marketing and promotional expenses. The increase in marketing and promotional expenses was primarily the result of Destia's spending in developing marketing and sales channels in Europe, as well as increased marketing expenditures to grow the retail customer base in North America.

Depreciation and amortization. Depreciation and amortization expenses increased to \$12.8 million for the six months ended June 30, 1999 from \$4.1 million for the six months ended June 30, 1998. This increase was substantially due to the continuing build-out of the Company's network in North America, the United Kingdom and continental Europe.

Interest expense and interest income. Interest expense increased to \$23.4 million for the first half of 1999 from \$18.5 million in the prior year comparable period. This increase was primarily attributable to higher interest expense incurred on the 1998 Notes due to the accretion of the principal balance, as well as interest expense incurred related to borrowings to finance the cost to acquire switches and other telecommunications equipment and IRUs. Interest income decreased to \$3.9 million in the first half of 1999 from \$6.2 million in the first half of 1998, primarily due to lower levels of cash and marketable securities.

Net loss. The Company reported a net loss of \$49.7 million for the first half of 1999 compared to a net loss of \$27.9 million for the first half of 1998. The increase in net loss reflects the increased SG&A expenses associated with the development of the Company's sales and marketing channels and the build out of its customer and network support infrastructure, as well as increased depreciation and amortization expenses and a higher level of net interest expense.

Liquidity and Capital Resources

The Company has incurred significant operating and net losses and made substantial capital expenditures, due in large part to the start-up and development of the Company's operations and its network. The Company will continue to incur additional losses and have substantial additional capital expenditures. The Company has utilized cash provided from financing activities to fund losses and capital expenditures. The sources of this cash have primarily been the proceeds from the Company's IPO in May of 1999, the issuance in 1997 of the Company's 13½% Notes (the "1997 Notes"), the issuance of the 1998 Notes and, to a lesser extent, equipment-based financing and an equity investment in preferred stock of the Company by Princes Gate Investors.

At June 30, 1999, Destia had approximately \$118.8 million in unrestricted cash, cash equivalents and marketable securities, compared to \$139.6 million in cash, cash equivalents and marketable securities at December 31, 1998. In addition, Destia had \$31.0 million of restricted cash and securities (which will be used to pay interest expense on the 1997 Notes through July 15, 2000) as of June 30, 1999. Destia's net cash used in operating activities was \$35.6 million for the six months ended June 30, 1999, and was primarily attributable to a net loss of \$49.7 million, an increase in accounts receivable of \$13.7 million and a decrease in accounts payable, accrued expenses and other current liabilities of \$7.4 million, partially offset by accreted interest expense of \$10.9 million and depreciation and amortization expense of \$12.8 million. Net cash used in investing activities of \$13.9 million for the six months ended June 30, 1999 was attributable to investments made primarily in switches and other telecommunications equipment, partially offset by the sale of marketable securities of \$21.3 million. Net cash provided by financing activities of \$40.7 million was primarily related to the net proceeds from the sale of Common Stock of approximately \$59.0 million partially offset by repayments of long-term debt of \$18.4 million.

Destia currently expects capital expenditures during 1999 to be below \$100 million, of which \$33.0 million was expended during the first six months of 1999. These investments will be made principally to support the continued growth of Destia's network, including the purchase of telecommunications equipment and the purchase of additional network capacity, as well as the continued development of Destia's back office capabilities, including its management information and network management systems.

The Company anticipates financing these expenditures primarily through term notes, capital leases with various lending institutions or its own cash resources. The Company's operations, continued development of its network and continued geographic expansion will continue to require substantial capital investment. Management believes it has the ability to continue to secure long-term equipment financing and to obtain funds from the high yield bond and equity markets. Management believes these abilities combined with available borrowing capacity under existing lines of credit and its own cash resources will be sufficient to fund capital expenditures, working capital needs and debt repayment requirements for the foreseeable future.

The Company continually evaluates business opportunities, including potential acquisitions, and engages in discussions with potential acquisition candidates. In June 1999, the Company purchased Wavetech Ltd., a reseller of wireless telecommunications in the United Kingdom. The Company will seek to acquire or align itself with complementary companies that (1) offer attractive opportunities in new geographic markets (with an emphasis on continental Europe), (2) have an established customer base or (3) have innovative telecommunications services or technologies (such as data transmission and wireless or Internet services). One or more of such acquisitions could result in a substantial change in the Company's operations and financial condition. The success of the Company's acquisition activities will depend, among other things, on the availability of acquisition candidates, the availability of funds to finance acquisitions and the availability of management resources to oversee the operation of acquired businesses.

On May 11, 1999, the Company completed an initial public offering of 6,500,000 shares of its common stock, par value \$.01 per share ("Common Stock"), which was priced at \$10.00 per share. The net proceeds to the Company (after deducting underwriter discounts and other expenses related to the offering) were approximately \$59.0 million.

Foreign Currency Exposure

Destia is exposed to fluctuations in foreign currencies relative to the U.S. dollar because Destia bills its end users in their local currency, while major portions of its transmission costs are incurred in U.S. dollars, and interest expense on the 1997 and 1998 Notes is in U.S. dollars. For the first six months of 1998 and 1999, approximately 46% and 37%, respectively, of Destia's revenues were billed in currencies other than the U.S. dollar, consisting primarily of British pounds, Belgian francs, German marks and Swiss francs. As Destia expands its operations, a higher percentage of revenues is expected to be billed in currencies other than the U.S. dollar. Destia, from time to time, uses foreign exchange contracts relating to its trade accounts receivables to hedge foreign currency exposure and to control risks relating to currency fluctuations. Destia does not use derivative financial instruments for speculative purposes. At June 30, 1998 and 1999, Destia had no open foreign currency hedging positions.

New Accounting Pronouncements

In March 1998, the American Institute of Certified Public Accountants (the "AICPA") issued Statement of Position ("SOP") 98-1, "Accounting for Costs of Computer Software Developed or Obtained for Internal Use." SOP 98-1 provides guidance on accounting for the costs of computer software developed or obtained for internal use software, dividing the development into three stages: (1) the preliminary project stage, during which conceptual formulation and evaluation of alternatives takes place, (2) the application development stage, during which design, coding, installation and testing takes place and (3) the operations stage during which training and maintenance takes place. Costs incurred during the application development stage are capitalized; all other costs are expensed as incurred. SOP 98-1 is effective for financial statements for

fiscal years beginning after December 15, 1998. The Company has adopted the provisions of SOP 98-1, and it has not had a material effect on the Company's results of operations.

In April 1998, the AICPA issued SOP 98-5, "Reporting on the Costs of Start-Up Activities." SOP 98-5 requires that all non-governmental entities expense the costs of start-up activities, including organization costs, as those costs are incurred. SOP 98-5 is effective for financial statements for fiscal years beginning after December 15, 1998. The Company has adopted the provisions of SOP 98-5 and it has not had a material effect on its results of operations.

Year 2000 Compliance

The Company is engaged in an ongoing process of assessing its exposure to the Year 2000 issue — the potential problems arising from computer systems that were designed to use two digits, rather than four, to specify the year. The Company has formed a project team (consisting of representatives from its information technology, finance, business development, product development, sales, marketing and legal departments) to address internal and external Year 2000 issues. By December 31, 1998, the Company had completed its internal review of its financial and other computer systems (which include switching, billing and other platforms) to assess Year 2000 issues. Based on this review, the Company believes that the amount of work and expense required to address Year 2000 issues relating to its internal systems will not be material. The Company has upgraded certain of its Northern Telecom switches to make them and their related software Year 2000 compliant. The Company had completed this upgrade as of June 30, 1999 at a cost of approximately \$1.3 million. In addition, the Company may be required to modify some of its other existing software. The Company estimates that it will have updated all of its significant internal systems to make them Year 2000 compliant and will have begun testing during the third quarter of 1999.

In addition to assessing its own systems, the Company has retained a consulting firm to assist it in conducting an external review of its significant customers, suppliers and other third parties with which it does business, including significant equipment and system providers and telecommunications service providers, to determine their vulnerability to Year 2000 problems and any potential impact that a lack of preparedness on such parties' behalf may have on the Company. In particular, the Company may experience problems to the extent that other telecommunications carriers are not Year 2000 compliant. The Company anticipates that this external review of the Company and related third parties will be substantially completed by September 30, 1999. The Company's ability to determine the status of these third parties' ability to address issues relating to Year 2000 issues is limited and there is no assurance that these third parties will achieve full Year 2000 compliance before the end of 1999.

The Company believes that its reasonably possible worst case Year 2000 scenario is disruption of its ability to route traffic over portions of its own network or an inability to terminate calls to certain destinations, which would require the Company to utilize other transmission capacity at greater cost. To the extent that a limited number of carriers experience disruption in service due to the Year 2000 issue, the Company's contingency plan is to obtain service from alternate carriers. However, there is no assurance that alternate carriers will be available or, if available, that the Company can purchase transmission capacity at a reasonable cost. In addition, in many continental European countries there are no alternative carriers to use. Significant Year 2000 failures in the systems of the Company, alternate carriers and other third parties (or third parties on whom they depend) would have a material adverse effect on the Company's business.

The Company estimates the total cost for resolving its Year 2000 issues to be approximately \$2.0 million, of which approximately \$1.4 million has been spent through June 30, 1999, with the majority of the expenditures incurred in the first two quarters of 1999 related to upgrades of its Northern Telecom switches. In addition, the Company spent approximately \$100,000 for consultant costs through June 30, 1999. The Company's overall estimate of Year 2000-related expenses includes the accelerated cost of replacing systems that are not Year 2000 compliant. Actual costs may, however, differ materially.

PART II

OTHER INFORMATION

Item 1. *Legal Proceedings*

The Company is, from time to time, a party to litigation that arises in the normal course of business. The Company is not presently a party to any litigation that it believes would reasonably be expected to have a material adverse effect on its business or results of operations.

Item 2. *Changes in Securities*

At the annual stockholders' meeting held on May 3, 1999, the stockholders approved an amended and restated certificate of incorporation of the Company and amended and restated bylaws. These modifications affect the holders of the Common Stock.

Pursuant to the stockholders' approval, the following material changes to the Company's certificate of incorporation and other changes were effected: (i) the number of authorized shares of Common Stock was increased from 29,250,000 to 72,000,000; (ii) the number of authorized shares of preferred stock was increased from 250,000 to 2,500,000; (iii) a stock split of 1.038916026 shares of Common Stock for every 1.0 shares was authorized to be completed upon consummation of the Company's IPO; (iv) at least 80% of the Company's stockholders must approve a material modification to the Company's bylaws; (v) action by written consent may not be taken at a stockholders' meeting unless approved by 66⅔% of the Company's stockholders.

The following material changes to the Company's bylaws were effected: (i) special meetings may be called only by the Board of Directors, the Chairman or the President of the Company; (ii) notice of stockholder meetings must be mailed between 10 and 60 days prior to such meeting; (iii) the size of the Board of Directors was increased to six directors; (iv) directors may be removed only for cause; (v) vacancies on the Board of Directors may be filled only by vote of a majority of Directors; (vi) stockholder proposals for an annual stockholders' meeting must be received by the Company at least 120 days prior to such annual meeting; and (vii) at least 80% of the Company's stockholders must approve a material modification to the Company's bylaws.

This summary description does not purport to be complete and is qualified in its entirety by reference to the Certificate of Incorporation and Bylaws of the Company previously filed with the Securities and Exchange Commission by the Company.

Item 3. *Defaults Upon Senior Securities*

None.

Item 4. *Submission of Matters to a Vote of Security Holders*

On May 3, 1999, the Company held its annual stockholders meeting during which all actions were taken by written consent.

The stockholders took the following action as well as certain other actions: (i) adoption of the Company's 1999 Flexible Incentive Plan; (ii) adoption of the Company's Employee Stock Purchase Plan; (iii) approval of an increase in the number of authorized shares of Common Stock reserved for the issuance of stock options under the 1996 Flexible Incentive Plan from 4,600,000 to 5,500,000 shares; (iv) approval of the Company's amended and restated certificate of incorporation and bylaws as described in Item 2 above; (v) ratification of the transfer of certain operating assets from the Company to a wholly owned operating subsidiary as of January 1, 1999; (vi) appointment of the Company's independent certified public accountants until the next annual meeting; and (vii) re-election of the Company's existing Board of Directors of the Company to serve until the next annual meeting.

Item 5. *Other Information*

On August 3, 1999, the Company filed two registration statements on Form S-8 with the Securities and Exchange Commission in order to register shares of its Common Stock in connection with employee-related stock plans. The Company registered 6,000,000 shares of Common Stock reserved for issuance of stock options under its 1999 Flexible Incentive Plan and 500,000 shares of Common Stock reserved for issuance under its Employee Stock Purchase Plan.

Item 6. *Exhibits and Reports on Form 8-K*

- (a) Exhibits — Exhibit 27.1 Financial Data Schedule.
- (b) The Company filed a report on Form 8-K on April 20, 1999.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DESTIA COMMUNICATIONS, INC.
(registrant)

Date: August 13, 1999

By /s/ ALAN L. LEVY
Name: Alan L. Levy
Title: President and Chief Operating Officer

Date: August 13, 1999

By /s/ PHILLIP J. STORIN
Name: Phillip J. Storin
Title: Senior Vice President and
Chief Financial Officer

**CERTIFICATE OF AMENDMENT
OF
AMENDED AND RESTATED
CERTIFICATE OF INCORPORATION
OF
VIATEL, INC.**

VIATEL, INC., a Delaware corporation organized and existing under the General Corporation Law of the State of Delaware (the "Corporation"), does hereby certify that:

FIRST: By unanimous written consent, the Board of Directors of the Corporation duly adopted a resolution recommending that the Corporation's Amended and Restated Certificate of Incorporation be further amended to increase the total number of shares of the Corporation's common stock, par value \$.01 per share, from Fifty Million (50,000,000) to One Hundred Fifty Million (150,000,000) and that the total authorized capital stock of the Corporation be increased from Fifty-two Million (52,000,000) to One Hundred Fifty-Two Million (152,000,000) (the "Amendment").

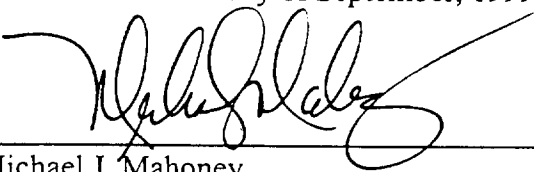
SECOND: At the 1999 Annual Meeting of the Stockholders of the Corporation held on September 14, 1999, which meeting was duly called and held upon notice in accordance with Section 222 of the General Corporation law of the State of Delaware (the "DGCL"), the necessary number of shares of the Corporation's common stock, par value \$.01 per share, were voted in favor of the Amendment.

THIRD: The Amendment was duly adopted in accordance with the provisions of Section 242 of the DGCL.

FOURTH: The first paragraph of Article IV of the Corporation's Amended and Restated Certificate of Incorporation is hereby further amended and restated to read as follows:

"The total authorized capital stock of the Corporation shall be One Hundred Fifty-Two Million (152,000,000) shares consisting of One Hundred Fifty Million (150,000,000) shares of common stock, par value \$.01 per share (the "Common Stock"), and Two Million (2,000,000) shares of preferred stock, par value \$.01 per share."

IN WITNESS WHEREOF, VIATEL, INC. has caused this Certificate of Amendment to be signed by its duly authorized officer this 17th day of September, 1999.



Michael J. Mahoney
Chairman, President and Chief Executive Officer

State of Delaware
Office of the Secretary of State PAGE 1

I, EDWARD J. FREEL, SECRETARY OF STATE OF THE STATE OF
DELAWARE, DO HEREBY CERTIFY THE ATTACHED IS A TRUE AND CORRECT
COPY OF THE RESTATED CERTIFICATE OF "VIATEL, INC.", FILED IN
THIS OFFICE ON THE EIGHTEENTH DAY OF OCTOBER, A.D. 1996, AT 8:30
O'CLOCK A.M.




Edward J. Freel, Secretary of State

2434412 8100

991253884

AUTHENTICATION: 9824561
DATE: 06-23-99

AMENDED AND RESTATED
CERTIFICATE OF INCORPORATION
OF
VIATEL, INC.

VIATEL, INC., a Delaware corporation (the "Corporation") organized and existing under the General Corporation Law of the State of Delaware (the "General Corporation Law"), does hereby certify that:

(1) The original Certificate of Incorporation of the Corporation was filed with the Office of the Secretary of State of the State of Delaware on September 16, 1994. A Certificate of Amendment of Certificate of Incorporation was filed with the Office of the Secretary of State of the State of Delaware on December 16, 1994 (together, with the original Certificate of Incorporation, the "Amended Certificate").

(2) The Amended and Restated Certificate of Incorporation of the Corporation was duly adopted in accordance with Sections 242 and 245 of the General Corporation Law by the Corporation's Board of Directors on October 11, 1996 and its stockholders on October 11, 1996.

(3) The Amended Certificate is hereby further amended as follows: (i) to provide for a 3-for-2 reverse stock split of the Corporation's Common Stock, \$.01 par value per share; (ii) to eliminate the Corporation's authorized shares of Series A Common Stock, \$.01 par value per share, (iii) to authorize a total of 1,000,000 shares of preferred stock, \$.01 par value per share (the "Preferred Stock"); and (iv) to provide for the division of the Corporation's Board of Directors into three classes.

(4) Except for (i) the inclusion of the foregoing amendments; (ii) the omission of matters of historical interest only; and (iii) the renumbering of the Amended Certificate to effect the omission of such matters, there are no discrepancies between the provisions of the Amended Certificate and the provisions of this Amended and Restated Certificate of Incorporation.

The text of the Amended Certificate is restated with the amendments described above, effective as of 9:00 a.m. on October 18, 1996, to read as follows:

ARTICLE I

The name of the corporation (the "Corporation") is: VIATEL, INC.

ARTICLE II

The address of the registered office of the Corporation in the State of Delaware is located at 1013 Centre Road, City of Wilmington, County of New Castle. The name of the registered agent at such address is the Corporation Service Company.

ARTICLE III

The nature of the business and purpose of the Corporation shall be to conduct any lawful business, to promote any lawful purpose and to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law.

ARTICLE IV

The total authorized capital stock of the Corporation shall be Fifty-One Million (51,000,000) shares consisting of Fifty Million (50,000,000) shares of Common Stock, par value \$.01 per share (the "Common Stock"), and One Million (1,000,000) shares of Preferred Stock, par value \$.01 per share.

Upon the filing of this Amended and Restated Certificate of Incorporation, the Corporation's shares of Common Stock, par value \$.01 per share, issued and outstanding immediately prior to the filing of this Amended and Restated Certificate of Incorporation (the "Old Common Stock") shall be changed so that every three (3) shares of Old Common Stock will automatically, and without any action on the part of the holder thereof, be converted into two (2) shares of Common Stock: provided, however, that no fractional shares shall be issued pursuant to such conversion and no payment shall be made for any fractional shares.

The following is a statement fixing certain of the designations and the powers, voting rights, preferences and relative, participating, optional and other rights of the Preferred Stock and the Common Stock of the Corporation, and the qualifications, limitations or restrictions thereof, and of the authority with respect thereto expressly granted to the Board of Directors of the Corporation to fix any such provisions not fixed by this Amended and Restated Certificate of Incorporation:

A. Preferred Stock.

The Board of Directors is hereby expressly vested with the authority to adopt a resolution or resolutions providing for the issue of authorized but unissued shares of Preferred Stock, which shares may be issued from time to time, in one or more series and in such amounts as may be determined by the Board of Directors in such resolution or resolutions. The powers, voting rights, designations, preferences and relative, participating, optional or other special rights, if any, of each series of Preferred Stock and the qualifications, limitations or restrictions, if any, of such preferences and/or rights (collectively, the "Series Terms"), shall be such as are stated and expressed in the resolution or resolutions providing for the issue of

such series of Preferred Stock (the "Series Terms Resolution") adopted by the Board of Directors. The powers of the Board of Directors with respect to the Series Terms of a particular series (any of which powers may by resolution of the Board of Directors be specifically delegated to one or more of its committees, except as prohibited by law) shall include, but not be limited to, determination of the following:

(1) The number of shares constituting that series and the distinctive designation of that series;

(2) The dividend rate on the shares of that series, whether such dividends, if any, shall be cumulative, and, if so, the date or dates from which dividends payable on such shares shall accumulate, and the relative rights of priority, if any, of payment of dividends on shares of that series;

(3) Whether that series shall have voting rights, in addition to any voting rights provided by law, and, if so, the terms of such voting rights;

(4) Whether that series shall have conversion privileges with respect to shares of any other class or classes of stock or of any other series of any class of stock, and, if so, the terms and conditions of such conversion upon the occurrence of such events as the Board of Directors shall determine;

(5) Whether the shares of that series shall be redeemable, and, if so, the terms and conditions of such redemption, including their relative rights of priority, if any, of redemption, the date or dates upon or after which they shall be redeemable, provisions regarding redemption notices, and the amount per share payable in case of redemption, which amount may vary under different conditions and at different redemption dates;

(6) Whether that series shall have a sinking fund for the redemption or purchase of shares of that series, and, if so, the terms and amount of such sinking fund;

(7) The rights of the shares of that series in the event of voluntary or involuntary liquidation, dissolution, or winding up of the Corporation, and the relative rights of priority, if any, of payment of shares of that series;

(8) The conditions or restrictions upon the creation of indebtedness of the Corporation or upon the issuance of additional Preferred Stock or other capital stock ranking on a parity therewith, or prior thereto, with respect to dividends or distribution of assets upon liquidation;

(9) The conditions or restrictions with respect to the issuance of, payment of dividends upon, or the making of other distributions to, or the acquisition or redemption of, shares ranking junior to the Preferred Stock or to any series thereof with respect to dividends or distribution of assets upon liquidation; and

(10) Any other designation, preference, power and right and any qualification, limitation or restriction thereon as may be fixed by resolution or resolutions of the Board of Directors under the General Corporation Law.

Any of the Series Terms, including voting rights, of any series may be made dependent upon facts ascertainable outside this Amended and Restated Certificate of Incorporation and the Series Terms Resolution, provided that the manner in which such facts shall operate upon such Series Terms is clearly and expressly set forth in this Amended and Restated Certificate of Incorporation or in the Series Terms Resolution.

B. Common Stock.

(1) Subject to the rights of the holders of shares of any series of Preferred Stock set forth in any Series Terms Resolution, the Board of Directors may, in its discretion, out of funds legally available for the payment of dividends and at such times and in such manner as determined by the Board of Directors, declare and pay dividends on the Common Stock of the Corporation.

(2) In the event of any liquidation, dissolution or winding up of the Corporation, whether voluntary or involuntary, after payment or provision for the payment of the debts and other liabilities of the Corporation and the payment or setting aside for payment of any preferential amount due to the holders of shares of any series of Preferred Stock, the holders of Common Stock, subject to the rights of the holders of any share of any class of stock or series ranking on a parity with the Common Stock as to the payment or distribution in such event, shall be entitled to receive ratably any and all assets of the Corporation remaining to be paid or distributed.

C. Voting.

Subject to the rights of the holders of shares of any series of Preferred Stock set forth in any Series Terms Resolution or provided by law, the holders of the Common Stock of the Corporation shall be entitled at all meetings of stockholders to one vote for each share of such stock held by them.

D. Retirement of Shares.

Unless otherwise provided in a Series Terms Resolution with respect to a particular series of Preferred Stock, all shares of Preferred Stock and all shares of Common Stock redeemed or acquired by the Corporation (as a result of conversion or otherwise) shall be retired and restored to the status of authorized but unissued shares.

E. No Preemptive Rights.

Unless otherwise provided with respect to a particular series of Preferred Stock in a Series Terms Resolution, no holder of shares of capital stock of the Corporation shall have any preemptive or other similar right, except as such rights are expressly provided by contract, to purchase or subscribe for or receive any shares of any class, or series thereof, of capital stock of the Corporation, whether now or hereafter authorized, or any warrant, option, bond, debenture or other security convertible into, exchangeable for or carrying any right to purchase any shares of any class, or series thereof, of capital stock of the Corporation.

ARTICLE V

The Corporation shall exist perpetually unless dissolved according to law.

ARTICLE VI

In furtherance and not in limitation of the powers conferred by statute, the Bylaws of the Corporation may be made, altered, amended or repealed by the Board of Directors.

ARTICLE VII

A. General Power of Board of Directors.

The powers of the Corporation shall be exercised by or under the authority of, and the business and affairs of the Corporation shall be managed under the direction of, a Board of Directors. The number of directors may be increased or decreased by the Board of Directors from time to time as provided in the Bylaws of the Corporation.

B. Classified Board of Directors.

The Board of Directors of the Corporation shall be divided into three classes designated as Class A, Class B and Class C, each initially composed of two persons. Upon any change in the size of the Board of Directors, each class shall consist, as nearly as may be possible, of one-third (1/3) of the total number of directors constituting the entire Board of Directors.

The initial term of office of Class A directors shall expire at the next annual meeting of stockholders of the Corporation following the filing of this Amended and Restated Certificate of Incorporation; the initial term of office of Class B directors shall expire at the second annual meeting of stockholders of the Corporation following the filing of this Amended and Restated Certificate of Incorporation; and the initial term of office of Class C directors shall expire at the third annual meeting of stockholders of the Corporation following the filing of this Amended and Restated Certificate of Incorporation. The initial designation of directors among Class A, Class B and Class C shall be made by the Board of Directors. At each annual meeting of stockholders, the successors to the class of directors whose term shall then expire shall be elected to hold office for a term expiring at the third succeeding annual meeting of stockholders. Each director shall hold office for the term for which he or she was elected and until his or her successor is elected and qualified or until his or her resignation or removal. Any vacancy on the Board of Directors for any reason shall be filled in accordance with the Bylaws of the Corporation.

ARTICLE VIII

Whenever a compromise or arrangement is proposed between this Corporation and its creditors or any class of them and/or between this Corporation and its stockholders or any class of them, any court of equitable jurisdiction within the State of Delaware may, on the application in a summary way of this Corporation or of any creditor or stockholder thereof or on the application of any receiver or receivers appointed for this Corporation under Section 291 of Title 8 of the Delaware Code or on the application of trustees in dissolution or of any receiver or receivers appointed for this Corporation under Section 279 of Title 8 of the Delaware Code order a meeting of the creditors or class of creditors, and/or of the stockholders or class of stockholders of this Corporation, as the case may be, to be summoned in such manner as the said court directs. If a majority in number representing three fourths in value of the creditors or class of creditors, and/or of the stockholders or class of stockholders of this Corporation, as the case may be, agree to any compromise or arrangement and to any reorganization of this Corporation as consequence of such compromise or arrangement, the said compromise or arrangement and the said reorganization shall, if sanctioned by the court to which the said application has been made, be binding on all the creditors or class of creditors, and/or on all the stockholders or class of stockholders, of this Corporation, as the case may be, and also on this Corporation.

ARTICLE IX

No director of the Corporation shall be personally liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except for liability (i) for any breach of the director's duty of loyalty to the Corporation or its stockholders; (ii) for any act or omission not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under Section 174 of Title 8 of the General Corporation Law, or (iv) for any transaction from which the director derived any improper personal benefit. The foregoing sentence notwithstanding, if the General Corporation Law is hereafter amended to authorize further limitations of the liability of a director of a corporation, then a director of the Corporation, in addition to the circumstances in which a director is not personally liable set forth in the preceding sentence, shall not be liable to the fullest extent permitted by the General Corporation Law as so amended. Any repeal or modification of the foregoing provisions of this Article IX by the stockholders of the Corporation shall not adversely affect any right or protection of a director of the Corporation existing at the time of such repeal or modification.

ARTICLE X

The Corporation shall, to the fullest extent permitted by Section 145 of the General Corporation Law, as the same may be amended and supplemented, indemnify any and all persons whom it shall have power to indemnify under Section 145 from and against any and all expense, liability, or other matter referred to in or covered by said section, and the indemnification provided for herein shall not be deemed exclusive of any other right to which

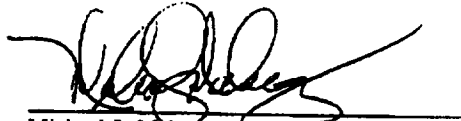
those indemnified may be entitled under any Bylaw, agreement, vote of stockholders or disinterested directors or otherwise, both as to action in his official capacity and as to action in another capacity while holding such office, and shall continue as to a person who has ceased to be a director, officer, employee, or agent and shall inure to the benefit of the heirs, executors, and administrators of such a person.

ARTICLE XI

The Corporation reserves the right to amend, alter, change or repeal any provision contained in this Amended and Restated Certificate of Incorporation, in any manner now or hereafter prescribed by statute, and all rights conferred upon stockholders herein are granted subject to this reservation.

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IN WITNESS WHEREOF, VIATEL, INC. has caused this Amended and Restated Certificate of Incorporation to be signed by its duly authorized officer this 11th day of October, 1996.



Michael J. Mahoney,
President and Chief Operating Officer

**CERTIFICATE OF AMENDMENT
OF
AMENDED AND RESTATED
CERTIFICATE OF INCORPORATION
OF
VIATEL, INC.**

VIATEL, INC., a Delaware corporation organized and existing under the General Corporation Law of the State of Delaware (the "Corporation"), does hereby certify that:

FIRST: By unanimous written consent, the Board of Directors of the Corporation duly adopted a resolution recommending that the Corporation's Amended and Restated Certificate of Incorporation be further amended to increase the total number of shares of the Corporation's Preferred Stock, par value \$0.01 per share, from One Million (1,000,000) to Two Million (2,000,000) and that the total authorized capital stock of the Corporation be increased from Fifty-One Million (\$1,000,000) to Fifty-Two Million (\$2,000,000) (the "Amendment").

SECOND: At the 1998 Annual Meeting of the Stockholders of the Corporation held on September 10, 1998, which meeting was duly called and held upon notice in accordance with Section 222 of the General Corporation Law of the State of Delaware (the "DGCL"), the necessary number of shares of the Corporation's common stock, par value \$0.01 per share, were voted in favor of the Amendment.

THIRD: The Amendment was duly adopted in accordance with the provisions of Section 242 of the DGCL.

FOURTH: The first paragraph of Article IV of the Corporation's Amended and Restated Certificate of Incorporation is hereby amended and restated to read as follows:

"The total authorized capital stock of the Corporation shall be Fifty-Two Million (52,000,000) shares consisting of Fifty Million (50,000,000) shares of Common Stock, par value \$0.01 per share (the "Common Stock"), and Two Million (2,000,000) shares of Preferred Stock, par value \$0.01 per share."

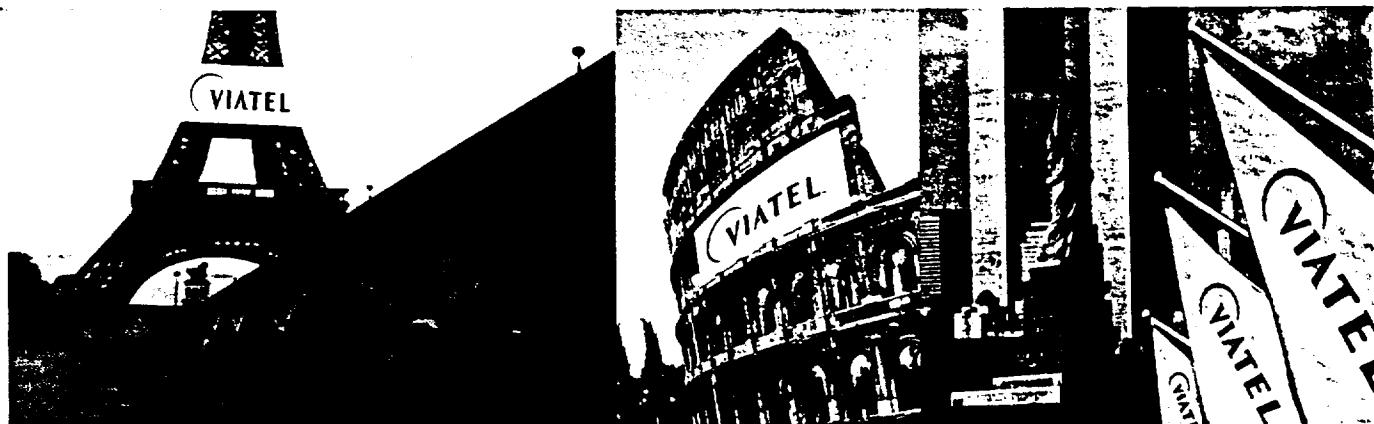
IN WITNESS WHEREOF, VIATEL, INC. has caused this Certificate to be signed by its duly authorized officer this 29 day of October, 1998.



Michael T. Mahoney
Chairman, President and Chief Executive Officer



No borders. No barriers. No limits.



“If there is a killer application in **global telecom**, it’s the ability to offer cross-border networking, data and Internet protocol **solutions** to business customers.”

— Jack B. Grubman

Managing Director of Salomon Smith Barney
as quoted in 7 June 1999 issue of *Barron's*

global

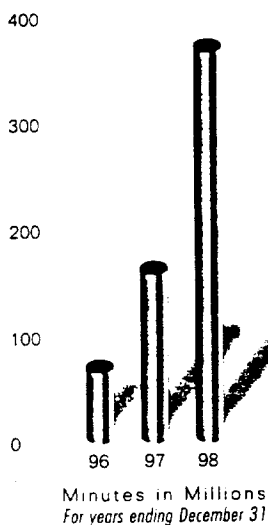
telecom

 **VIATEL™**

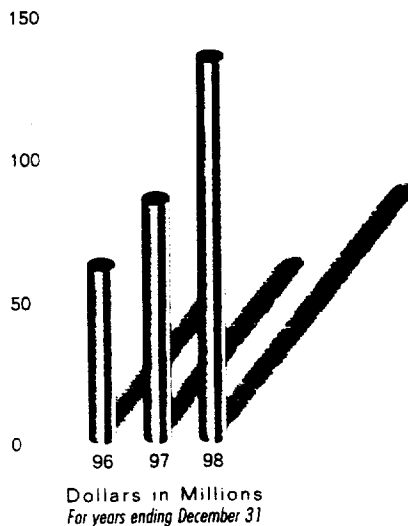
solutions

Highlights

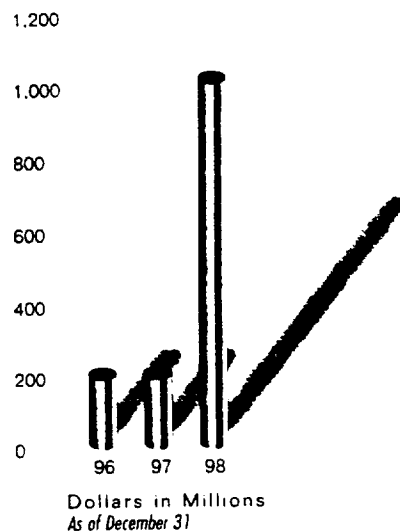
Minutes



Revenues



Total Assets

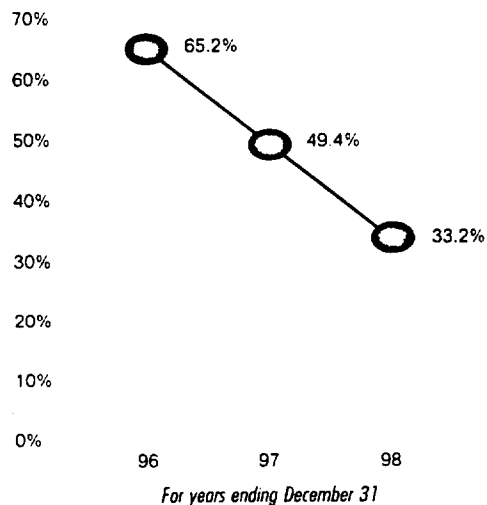


Selected Financial Data

Dollars in Millions

	For years ending December 31		
	1996	1997	1998
Revenue	\$ 50.4	\$ 73.0	\$ 135.2
% Growth	56.0%	44.8%	85.1%
Gross Profit	8.3	9.5	13.1
SG&A Expense	32.9	36.1	44.9
% of Revenue	65.2%	49.4%	33.2%
EBITDA	(24.6)	(26.6)	(31.8)
% of Revenue	(48.7%)	(36.4%)	(23.5%)

SG&A/Revenue



Dear fellow stockholder:

Nineteen ninety-eight was a pivotal year for Viatel.

In the span of one short year, we conceived, financed, and began building our Circe Pan-European Network, Western Europe's most advanced and extensive fiber network. In the process, we transformed the Company from a telecommunications reseller into a facilities-based, integrated communications provider capable of delivering voice, data, and Web-based services throughout Western Europe.

Nineteen ninety-eight was also a year in which we delivered record financial results: revenue increased an impressive 85 percent over 1997. We also delivered an outstanding 352 percent total stockholder return.

This annual report details how we achieved our record financial results, our strategies for leveraging the Circe Network and our plans for future expansion. More specifically, it focuses on what Circe means for our customers, for Viatel, and for you.

A Vision and a Promise

We began 1998 with both a vision and a promise.

We believe that the deregulating European telecommunications marketplace and the competition that has ensued, coupled with exploding business bandwidth requirements and growing consumer demand, create major opportunities for Viatel. A revolutionary technological shift in telecommunications is occurring today — the convergence of voice, data and media. This shift is redefining the way telecommunications companies do business and is requiring "next-generation" networks that can support this change. Our vision is to position strategically Viatel to take full advantage of this change.

We set out to build an unparalleled, state-of-the-art, pan-European network; one that meets the growing demands of customers for existing services and serves as the platform for services and applications of the future. The initial implementation of this vision is our Circe Network, which, when completed, will be an 8,700 route kilometer, multi-ring, high-capacity, self-healing, broadband infrastructure linking over 40 cities in the United Kingdom, France, Belgium, Germany, The Netherlands and Switzerland. Circe is engineered to be the most extensive, reliable and scalable cross-border broadband network in Europe today, positioning Viatel to be the value leader among communications providers.

Understanding that early market entry is critical, we set a very aggressive timetable to complete the first phase of the Circe Network, one which many believed would be impossible to achieve. Then, in April 1998, we raised the capital to fully fund the initial phases of the Circe project, assembled a top-notch project team, and contracted with world-class suppliers of fiber-optic cable, equipment and software. By the beginning of 1999, we delivered on our promise: the first phase of the Circe Network was completed on time and on budget — marking Viatel's official transition to a facilities-based, integrated communications provider.

In addition to owning infrastructure, we believe that licenses and interconnection are essential to compete in the new telecommunications market being revolutionized by declining prices and increasing consumer demand. During 1998, we successfully secured licenses to provide unrestricted voice services and to own and operate infrastructure. We also pursued operational interconnection in the Circe countries. Our efforts to secure licenses and interconnection throughout Western Europe have continued in 1999, affirming our commitment to extending our network footprint.

Clockwise from bottom, Michael J. Mahoney, Lawrence G. Malone, Allan L. Shaw, Sheldon M. Goldman, Francis J. Mount



Michael J. Mahoney
President and
Chief Executive Officer

Allan L. Shaw
Senior Vice President, Finance;
and Chief Financial Officer

Lawrence G. Malone
Senior Vice President,
Global Sales and Marketing

Sheldon M. Goldman
Senior Vice President,
Business Affairs; and
General Counsel

Francis J. Mount
Senior Vice President,
Engineering and
Network Operations

A Strong Performance

Our strong operating performance in 1998 was equally impressive. With revenue growing 85 percent to \$135 million and minutes-of-use rising 172 percent to 384 million, we have significantly grown our business. Also notable was our success in reducing selling, general and administrative expenses which, as a percentage of revenue, declined over the year.

Our growth in 1998 was achieved without the benefit of network ownership, a factor that fundamentally changes Viatel's prospects for future growth and earnings. Network ownership provides a low cost position that will allow us to remain price competitive and to achieve significant gains in our gross margins. In addition, we should enjoy additional revenue streams as we roll out new value-added services on the Circe Network.

New Market Opportunities

In the U.S., generational changes have already occurred as data networking, communications, computing applications and media converge via the Internet. In Europe, where competition has been limited and deeply rooted business patterns have developed as a result of inadequate telecommunications infrastructure, the changes made possible by networks, such as Circe, promise to be even more profound.

Data connectivity is clearly the growing force in communications today. Data communications traffic is projected to overtake voice traffic in the near future. In fact, we believe it is already the primary network driver. While traditional international and national long distance services in Western Europe represent a \$220 billion dollar opportunity, we believe that the Internet services market in Western Europe represents an even greater opportunity for Viatel. The Internet services market alone is projected to be a \$100 billion opportunity by 2001 and is expected to grow at a 60 percent compounded annual rate for many years to come.

The Circe Network has been designed to support Internet protocol-based applications running over frame relay, asynchronous transfer mode (ATM) and synchronous digital hierarchy (SDH). In fact, in the first quarter of 1999 we entered into an alliance with Lucent Technologies to test and showcase Lucent's data products and services in Europe via Circe. In return, we will receive access to Lucent's next-generation networking technology. This alliance should allow us to jointly create a product platform tailored to meet the needs of our European customers.

The Year Ahead

In the past year, we began to put in place the critical building blocks to address the emerging opportunities in Europe — a superior network, a highly skilled management team and fully developed back office capabilities. Now, we must continue to expand our capabilities and fully leverage our network infrastructure.

Already in 1999, we have begun offering new services on Circe. We are currently providing private line services throughout many Circe countries and will soon be introducing data services.

Our network construction progress and operational success have also allowed us to access the capital markets in 1999 to further fund our growth. In the first half of 1999, we raised approximately \$365 million through a high yield debt offering and \$200 million in an equity offering. These offerings were completed within a year and a half after placing approximately \$900 million of high yield debt to fund the initial phases of the Circe Network. Our recent fund-raising activities allow us to expand the Circe Network to include Southern France and Switzerland, to deploy additional applications, and to add resiliency and redundancy within the network. Importantly, our continued ability to access the capital markets illustrates the confidence which our investors have in our ability to execute our plans.

In closing, I thank you for supporting our strategy and our dedicated employees who have worked diligently to deliver on our promises. On behalf of management and our board, we appreciate your commitment and enthusiasm.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael J. Mahoney", with a large, stylized flourish extending from the end of the signature.

Michael J. Mahoney

Chairman, President and Chief Executive Officer

**The Telecommunications
Revolution in Europe —
the Circe Story**

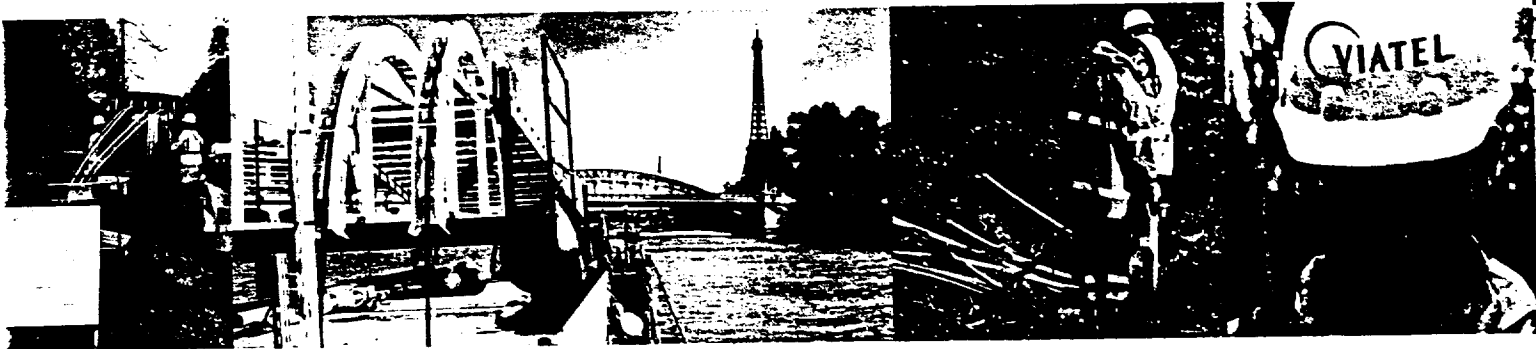
Telecommunications Takes Hold in Europe

In the United States today, the availability of affordable telecommunications services is often taken for granted. Since the break-up of "Ma Bell," competition has led to a dramatic reduction in the cost of voice calls, a proliferation of varied service options and perhaps, most importantly, the development of the infrastructure that supports networks of every size and type. From the explosion of the Internet and e-commerce, to the transformation of rudimentary business computing into advanced global networks, telecommunications technology has changed the daily lives and work patterns of virtually every person.

Until 1998, however, the situation in Western Europe was dramatically different. Europe has been disadvantaged by aging voice networks, most of which were built by the same government-affiliated organizations that exercised monopolistic control over rates, service and supply.

Europe has lacked the cross-border, fiber network necessary for advanced telecommunications applications and services.

Even with the general movement towards telecommunications deregulation and the initiatives undertaken by the European Union to accelerate this process, one key element for successful implementation has been missing. Europe has lacked the cross-border, fiber network necessary



for advanced telecommunications applications and services. Without a highly reliable fiber network capable of linking advanced switching, routing and multiplexing equipment and supporting both voice and data, the deployment of new technology in Europe represented an additional load on aging and overburdened national networks.

It is against this backdrop that Viatel — an early entrant into the liberalized markets of Western Europe — made the decision in 1998 to engineer, build and operate the Circe Network. The premise behind Circe is simple: an advanced, cross-border fiber network in Western Europe designed to deliver a wide range of services, from voice telephony to data to advanced multimedia applications, at the lowest possible cost but with the highest levels of quality and reliability.

Deregulation of telecommunications markets and services in the European Union has already created significant changes in consumer behavior. In many countries, both call volumes and average call durations have increased, as consumers and businesses respond to more affordable and accessible communications services. Moreover, consumers are increasingly shifting to new carriers. For example, during the past year in Germany, nearly 30 percent of international consumer voice call volume has shifted to new carriers from the incumbent provider. Experts had predicted that less than five percent of the market would shift during the first five years of competition.

Voice telephony, while an ever increasing opportunity for new carriers, is being dwarfed by the enormous opportunity presented by the growth of data networking within Europe.



particularly among small and medium-sized businesses. For example, in the European Union, small and medium-sized businesses, usually defined as less than 250 employees, account for 66 percent of all business employment and 55 percent of total business revenue. Yet, these segments historically have had the least access to the key component of data networking: available and reasonably priced transmission services. The Circe Network can satisfy these requirements.

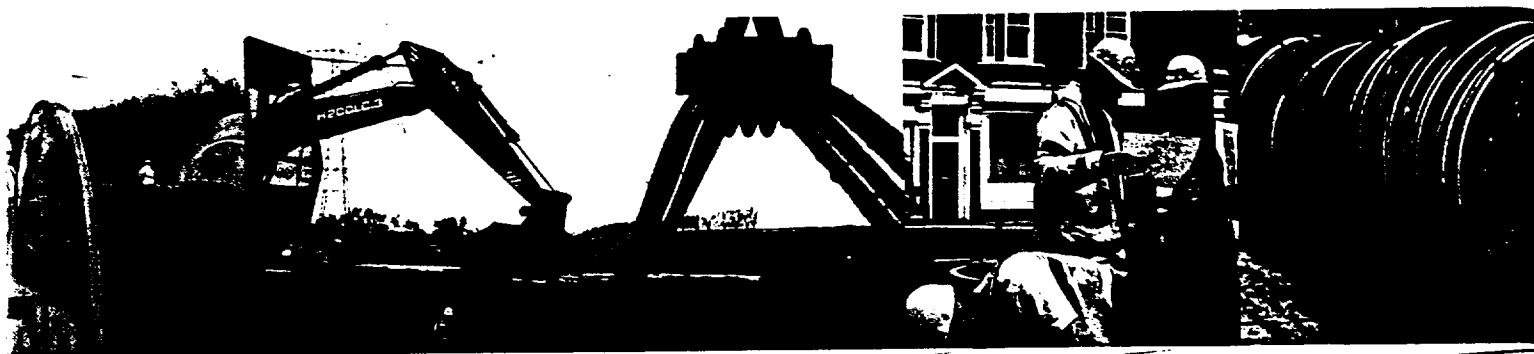
The Circe Network, coupled with the explosive growth of Internet-based traffic, will significantly transform the way small and medium-sized businesses operate, as a new generation of employees take advantage of new communications tools ranging from call centers and 800-number services to e-commerce and Web-based business techniques. In fact, on-line sales in Western Europe are projected to rise to more than \$64 billion by 2001 from less than \$1 billion today. While this is less than half the comparable U.S. total, the projected growth rate for Western Europe is almost three times as fast.

As a result of the introduction of new networks like Circe, experts predict that the price of data communications will drop by as much as 65 percent over the next two years. At the same time, the number of on-line users in Western Europe is expected to triple, from 22 million in 1998 to almost 70 million in 2002. This growth is dependent on the existence of sufficient network capacity, equipped to handle Internet traffic that is priced at affordable rates.

The U.S. market has already witnessed the fundamental shift that has taken place as data networking, communications, computing applications and media have converged via the Internet. In Europe, where competition has been limited and deeply-rooted business patterns have developed as a result of the lack of modern telecommunications infrastructure, the changes made possible by the Circe Network promise to be even more profound.

The Birth of Circe

When we made the decision to build the Circe Network, we had been competing in the liberalized markets of Western Europe using network capacity leased from other carriers. However, we understood that in a price-declining environment, only those carriers that



owned and controlled their own network infrastructure would have the low-cost structure necessary to compete. Equally important, the quality and reliability demanded by advanced data communications were unlikely to be met through leased circuits.

**With the turn-up of service in March 1999,
Circe represents a remarkable accomplishment:
the creation of a cross-border, advanced fiber network
in less than a single year.**

10

To provide an alternative, we developed a fast-track plan for design and construction of Circe, and raised approximately \$900 million of high yield debt in 1998. We recruited some of the world's leading construction, technology and engineering partners, including Bechtel, Lucent Technologies, Nortel Networks and Alcatel Submarine Networks, to bring our plan to fruition. With the turn-up of service in March 1999, Circe represents a remarkable accomplishment: the creation of a cross-border, advanced fiber network in less than a single year.

The Future of Telecommunications Is Here

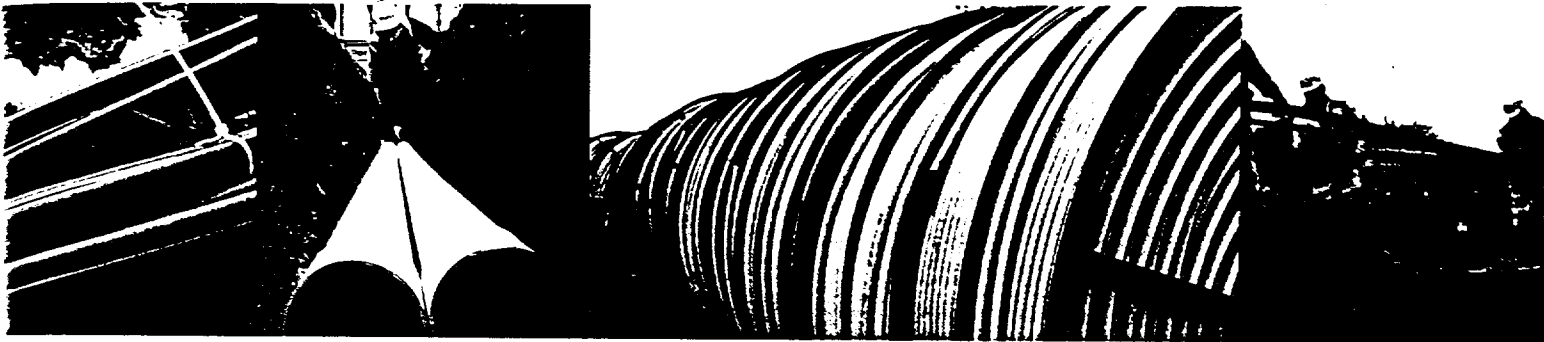
The Circe Network, when completed, will be an 8,700 route kilometer fiber-optic telecommunications network linking major business centers of Western Europe. Circe will connect over 40 cities in the the United Kingdom, France, Belgium, Germany, The Netherlands and Switzerland using state-of-the-art fiber. Circe includes 312 route kilometers of

submarine cable, linking continental Europe with switching and network operations centers in the United Kingdom which monitor and direct traffic across the network. The Circe Network also provides connectivity with trans-Atlantic cable systems to the U.S. and other cable systems into Asia.

Circe functions as a high-speed, cross-border backbone, capable of transporting and delivering a wide variety of long-distance and data "feeder" traffic that can enter and exit the network from many different local access points. Through interconnection with existing local telephone systems, and lines owned by other carriers and business users, Circe can serve a far broader population and geographic area than simply those locations through which the network actually passes.

**Use of fiber and new fiber-related technologies in the Circe Network
fundamentally alters the economics of networking,
resulting in Viatel's ability to offer a greater variety of
communications services to users at low prices.**

While fiber networks have become commonplace in the U.S., few have been built across Europe. Use of fiber and new fiber-related technologies in the Circe Network fundamentally



alters the economics of networking, resulting in the ability to offer a greater variety of communications services to users at low prices.

The Circe Network employs the latest optical technology innovations, including Lucent Technologies new truewave reduced slope fiber, dense wave division multiplexing (DWDM), and synchronous digital hierarchy (SDH), providing high capacity, flexibility and reliability for the network. Circe is initially carrying 20 gigabits of information per second on a single pair of fiber; Circe comprises an average of 65 strands of fiber. However, thanks to the advanced optronics and glass employed on the Circe Network, a single pair of fiber can be expanded in the future by a factor of 16, to deliver 320 gigabits per second, without any additional optronics and without service interruption. In the near future, advanced optronic innovations are expected to allow Circe to deliver two terabits of capacity per fiber. For Viatel, the scalability of Circe translates into being a low-cost provider in Europe.

The Circe Network also offers increased flexibility in handling and switching combined voice (circuit-switched) and data (packet-switched) traffic, expanding the range of services available, increasing traffic volumes and lowering overall overhead costs and pricing. The result, in a market starved for bandwidth, is a vastly expanded range of opportunities for low-cost Internet access, e-commerce and data networking by smaller businesses.

Circe's design and engineering add another element to the benefit equation: reliability, which is essential to the successful development of business-oriented data communications applications. Circe's fiber infrastructure is bi-directional, meaning that if a fiber cable is damaged or broken, the signal will reach its desired destination through an alternative route. Circe is also self-healing, meaning that it can restore itself instantaneously, virtually eliminating any downtime in the event of a single fiber cut or a transmission fault.

**Circe represents an innovative forerunner of Europe's
next-generation telecommunications networks that will enable
a wide variety of communications benefits and applications.**

By utilizing state-of-the-art components and bringing them together in a remarkably short time period — less than one year from the completion of financing to the first



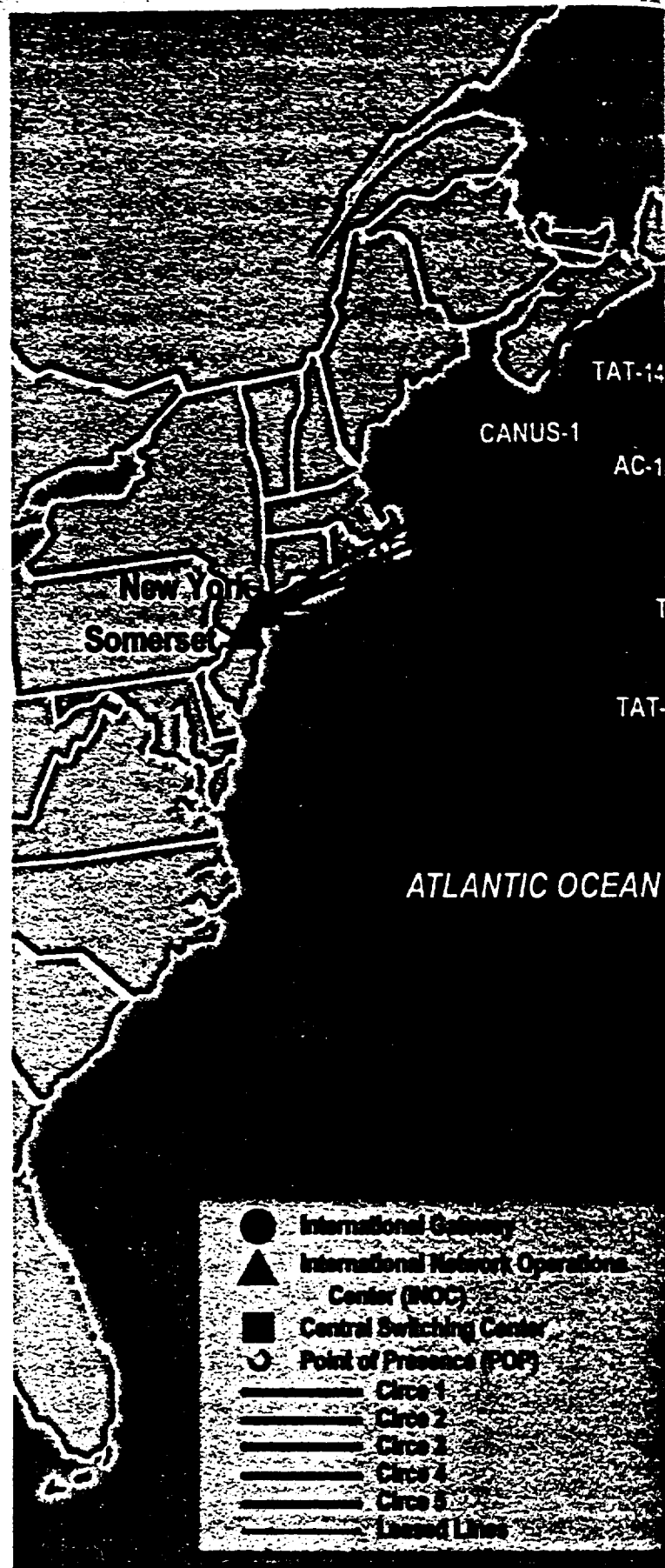
12

service deployment — we have created an innovative forerunner of Europe's next-generation telecommunications networks that will enable a wide variety of communications benefits and applications. For consumers in countries serviced by it, Circe should promote rate competition, making long-distance calling within countries and across borders an affordable reality. It should also accelerate the availability of affordable, consumer Internet access services.

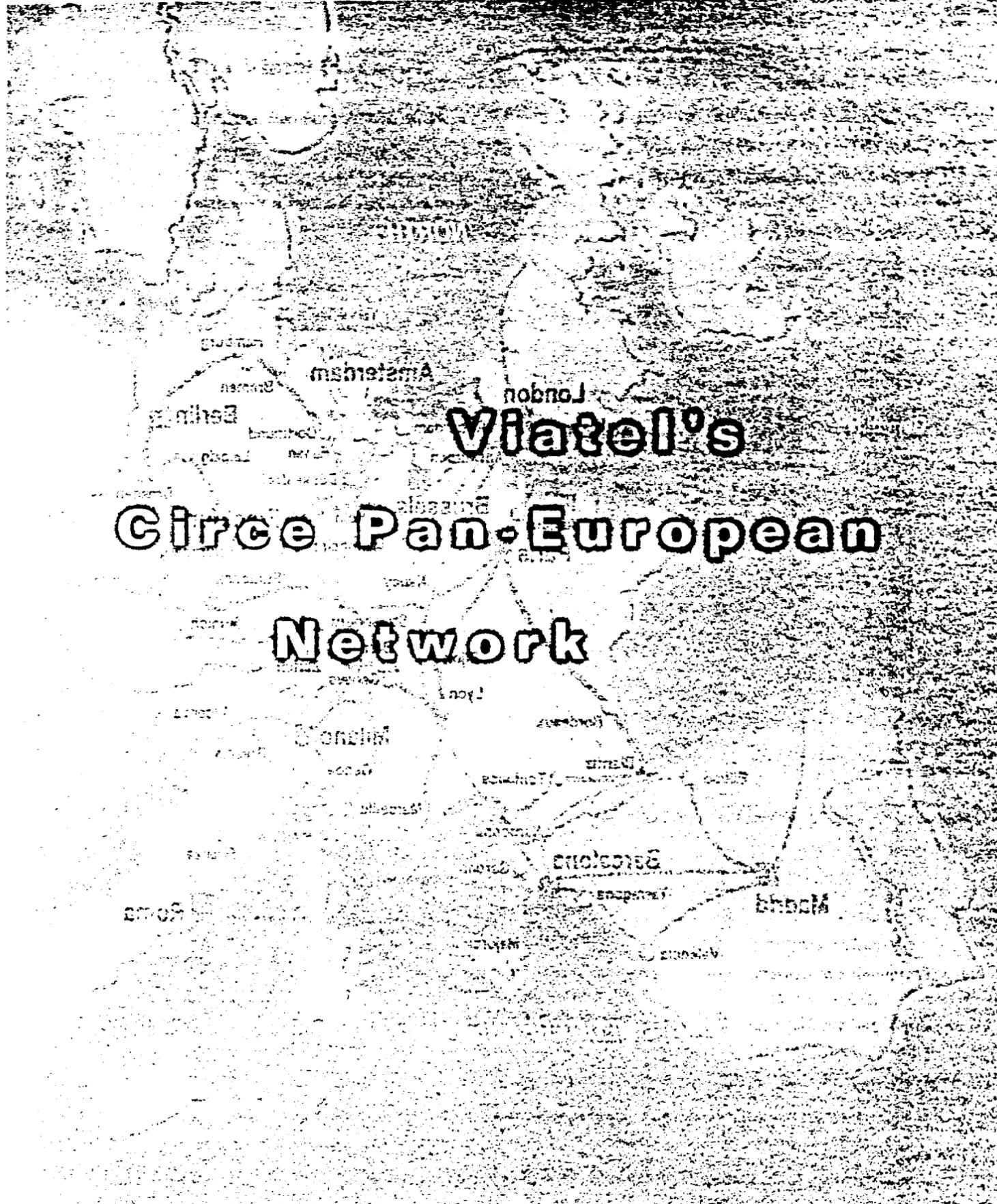
For small and medium-sized businesses, telecommunications services built upon Circe's infrastructure will help guarantee these companies' ability to develop and support new customers and offerings within new regions and across borders. Low-cost data services and readily available bandwidth can be used to connect company locations, facilitate coordination with suppliers and manufacturing plants, and launch new businesses. None of these benefits is possible without the existence of advanced network infrastructure, of which Circe is Europe's leading example.

The Viatel Network

The Circe Pan-European Network, part of Viatel's global network, soon will deliver affordable voice and data communications services to end-users in over 40 major cities within six Western European countries. For the first time, consumers and businesses in these regions will enjoy unfettered access to economical long-distance voice services, advanced data services, high-speed Internet access, e-commerce and multimedia applications. By spanning national borders and providing the fiber-optic platform required for next-generation convergence services, the 8,700 route kilometer Circe Network will be a prime catalyst for the future technology explosion that promises to transform the telecommunications market in Western Europe.







Viattel's
Circe Pan-European
Network



Selected

Financial Data

The following selected Consolidated Statement of Operations, Other Financial Data and Balance Sheet Data as of and for the years ended December 31, 1998, 1997, 1996, 1995 and 1994 have been derived from our Consolidated Financial Statements and the notes related thereto, which were audited by KPMG LLP, Independent Certified Public Accountants. The consolidated financial statements as of December 31, 1998 and 1997 and for each of the years in the three-year period ended December 31, 1998 and the report of KPMG LLP thereon, are included elsewhere in this Report. This information should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" our Consolidated Financial Statements, including the notes thereto, and the other financial data included elsewhere in this Report.

	Year Ended December 31:				
(In thousands, except per share and other operating data)	1998	1997	1996	1995	1994
CONSOLIDATED STATEMENT OF OPERATIONS DATA:					
Communication services revenue	\$ 135,188	\$ 73,018	\$ 50,419	\$ 32,313	\$ 26,268
Operating expenses:					
Cost of communication services	122,109	63,504	42,130	27,648	22,953
Selling, general and administrative	44,893	36,077	32,866	24,370	14,463
Depreciation and amortization	16,268	7,717	4,802	2,637	789
Equipment impairment loss	-	-	-	560	-
Total operating expenses	183,270	107,298	79,798	55,215	38,205
Operating loss	(48,082)	(34,280)	(29,379)	(22,902)	(11,937)
Interest income	28,259	3,686	1,852	3,282	214
Interest expense	(79,177)	(12,450)	(10,848)	(8,856)	(772)
Loss before extraordinary loss	(99,000)	(43,044)	(38,375)	(28,476)	(12,495)
Extraordinary loss on debt prepayment	(28,304)	-	-	-	-
Net loss	(127,304)	(43,044)	(38,375)	(28,476)	(12,495)
Dividend on redeemable convertible preferred stock	(3,301)	-	-	-	-
Net loss attributable to common stockholders	\$ (130,605)	\$ (43,044)	\$ (38,375)	\$ (28,476)	\$ (12,495)
Loss per common share, basic and diluted (1):					
Before extraordinary item	\$ (4.44)	\$ (1.90)	\$ (2.47)	\$ (2.09)	\$ (1.22)
From extraordinary item	(1.23)	-	-	-	-
Net loss attributable to common stockholders	\$ (5.67)	\$ (1.90)	\$ (2.47)	\$ (2.09)	\$ (1.22)
OTHER FINANCIAL DATA:					
EBITDA (2)	\$ (31,814)	\$ (26,563)	\$ (24,577)	\$ (20,265)	\$ (11,148)
Net cash used in operating activities	(60,318)	(22,525)	(26,331)	(18,489)	(11,571)
Net cash used in investing activities	(349,992)	(43,164)	(1,592)	(37,057)	(4,996)
Net cash provided by (used in) financing activities	729,035	11,286	94,772	(2,306)	80,984
Capital additions (3)	220,903	40,214	9,800	11,887	4,267
OTHER OPERATING DATA:					
Billable minutes (000s)	383,875	140,918	62,249	25,932	14,981
Switches (4)	15	14	13	10	2
Points of presence (4)	34	33	13	11	3
BALANCE SHEET DATA (4):					
Cash, cash equivalents and marketable securities	\$ 501,282	\$ 47,143	\$ 92,982	\$ 35,066	\$ 66,762
Restricted cash equivalents and restricted marketable securities (5)	144,523	-	-	-	-
Property and equipment, net	266,256	54,094	21,074	15,715	6,933
Total assets	1,009,111	126,809	134,664	65,613	83,923
Long-term debt, excluding current installments	921,139	99,610	77,904	67,283	59,955
Redeemable convertible preferred stock	47,121	-	-	-	-
Stockholders' (deficiency) equity	(137,292)	(8,564)	38,483	(17,618)	10,985

(1) Net loss per share is computed on the basis described in Note 1 of our Consolidated Financial Statements.

(2) As used herein, "EBITDA" consists of earnings before interest, income taxes, extraordinary loss, dividends on convertible preferred stock and depreciation and amortization. EBITDA is a measure commonly used in the telecommunications industry to analyze companies on the basis of operating performance. EBITDA is not a measure of financial performance under generally accepted accounting principles, is not necessarily comparable to similarly titled measures of other companies and should not be considered as an alternative to net income as a measure of performance nor as an alternative to cash flow as a measure of liquidity.

(3) Capital additions for each period consist of capital expenditures, the net increase in payables for property and equipment purchases, assets acquired under capital lease obligations and capitalized investment during the period.

(4) Information presented as of the end of the periods indicated.

(5) Restricted cash equivalents include \$9.3 million of funds deposited by Metromedia Fiber Networks, Inc. and Carier 1, Inc. in connection with the joint construction of civil works associated with a national communications network being constructed by each party in Germany. See Note 3 to our Consolidated Financial Statements. Restricted marketable securities represents government obligations purchased by us which secure the payment of the next five interest payments on our outstanding senior notes.

The following discussion should be read in conjunction with our financial statements, the notes thereto, and the other financial data included elsewhere in this Report.

OVERVIEW

Since Viatel's inception in 1991, we have invested heavily in developing our ability to provide international communications services within Western Europe and expanding our market presence. During the past seven years, we have made substantial investments in software and back office operations, an administrative infrastructure and a direct sales organization in Western Europe. Furthermore, we have created an extensive commercial telecommunications network in Western Europe which we believe is necessary to economically render the voice and data services we offer and intend to offer. We have also expanded our ability to generate revenues in North America during 1998. Currently, our revenues are derived from wholesale and retail sales. Beginning in 1999, our revenues are expected to be derived from three primary sources: wholesale sales, retail sales (which is composed of sales to end users) and revenue from the sale of capacity on our network. Each revenue source has a different impact on our results of operations. The sale of capacity on the Circe Network will vary substantially from period to period and will result in fluctuations in our operating results. For a discussion of the effects of the Circe Network on communication services revenue and other line items, see "— The Circe Network."

COMMUNICATION SERVICES REVENUE

Our communication services revenue is currently based primarily on the number of minutes of use billed ("billable minutes") and, to a lesser extent, on the additional services and products provided through our network. We currently derive our communication services revenue principally from long distance telecommunications services.

During recent years, the following key trends have affected the composition of our communication services revenue:

- A growing proportion of our customers, particularly in Western Europe, now access our network using either "indirect access" or "dedicated access" rather than call re-origination or international toll-free access (See "Business — The Viatel Network").
- We have continued to expand our wholesale business. Our acquisition of Flat Rate Communications, Inc. during 1998 resulted in a significant increase in our wholesale business, and also increased our North American revenues. We believe that the revenues generated in North America will continue to increase.
- The Western European market has increased in importance for us. In contrast, communication services revenue from Latin America and Asia/Pacific Rim has declined and is expected to continue to decline as a percentage of total communications revenue as we continue to grow our business in Western Europe.

The table set forth below presents our communication services revenue, as a percentage of total revenue, from different regions (based on where calls originated on our network):

	Year Ended December 31.		
	1998	1997	1996
Western Europe	46.6%	44.7%	39.5%
North America	41.6	21.9	18.9
Latin America	10.8	22.2	28.6
Asia/Pacific Rim and Other	1.0	11.2	13.0

We have experienced, and expect to continue to experience, declining revenue per minute in all of our markets, in part as a result of increasing worldwide competition within the telecommunications industry. We believe, however, that the impact on our results of operations from price decreases will be at least partially offset by (1) continuing decreases in our cost of providing telecommunications services, particularly those decreases resulting from our continued efforts to convert from leased to owned infrastructure and reduce interconnection costs through the use of the Circe Network as it is expanded, (2) the introduction of new products and services and (3) our ability to enter into additional interconnection agreements. There can be no assurance, however, that these results, including a decline in our cost of communication services, can be achieved.

COST OF COMMUNICATION SERVICES

Our cost of communication services can be classified into three general categories: access costs, network costs and termination costs. Access costs generally represent the costs associated with transporting the traffic from a customer's premises to the closest access point on our network. Access costs vary depending upon the distance from our network to the customer's premises and from country to country. We currently expect that our effective per minute cost will be reduced as deregulation continues and competition accelerates, certain European Union directives requiring cost-oriented pricing (i.e., costs that an effectively competitive market would yield) by incumbent telecommunications operators are enforced and as we are able to obtain cost effective interconnection agreements. However, we can provide no assurance regarding the extent or timing of such cost decreases. In the event that such access costs do not fall as fast as we expect or not at all, our gross margins could be adversely impacted.

Network costs represent the costs of transporting calls over our network from its point of entry to its point of exit. Network costs generally consist of leased line rental costs and costs associated with interconnection with facilities of incumbent telecommunications operators. These costs will decrease substantially as each ring of the Circe Network is placed into service and we secure infrastructure ownership on other routes, which will enhance gross margins. However, there will be an associated increase in depreciation and amortization expense (which is included in a different line item). In order to succeed, we will need our per minute network costs to decline substantially compared to our per minute revenue. See "— Depreciation and Amortization."

Termination costs currently represent the costs which we are required to pay to other carriers from the point of exit from our network to the point of destination. Termination costs are generally variable with traffic volume and traffic mix. If a call is terminated in a city in which we have a switch or point of presence, the call is usually transferred to the public switch telephone network for local termination. If the call is to a location in which we do not have a switch or point of presence, then the call must be transferred to another carrier with which we are interconnected.

We utilize least cost routing designed to terminate traffic in the most cost effective manner. We believe that local termination costs should decrease as we (1) add additional switches and points of presence, (2) interconnect with additional incumbent telecommunications operators and other infrastructure providers and (3) construct or purchase additional transmission facilities. Local termination costs should also decrease as new telecommunications service providers emerge and, in Western Europe, as European Union member states implement and enforce regulations requiring incumbent telecommunications operators to establish rates which are set at the forward-looking, long run economic costs that would be incurred by an efficient provider using state-of-the-art technology. We cannot provide any assurance regarding the results referred to in the foregoing forward-looking statements, including the extent or timing of cost decreases.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Our selling, general and administrative expenses include commissions paid to independent sales representatives and overhead costs associated with our headquarters, back office and network operations centers and sales offices. Our selling, general and administrative expenses have continued to increase since our inception as we developed and expanded our business, although these expenses have fallen as a percentage of communications revenue. We anticipate that these expenses will continue to increase as our business is expanded in the future, however, we cannot provide any assurance that this will be the case. We anticipate that these expenses will continue to be incurred in advance of anticipated related communication services revenue.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization expense includes charges relating to depreciation of property and equipment, which consist principally of telecommunications-related equipment such as switches and points of presence, indefeasible rights of use and minimum investment units, furniture and equipment, leasehold improvements, and amortization of intangible assets, including goodwill and costs associated with acquired employee bases and sales forces. We depreciate our network over periods ranging from five to 15 years and amortize our intangible assets over periods ranging from three to 25 years. We expect depreciation and amortization expense to increase as we further expand our network, particularly as each ring of the Circe Network is placed into service, at least until significant portions of the Circe Network are sold.

THE CIRCE NETWORK

The Circe Network is expected to have significant effects on our results of operations. The sale of capacity on the Circe Network will vary substantially from period to period and, as a result, may result in fluctuations in our operating results. We will capitalize all of the costs associated with designing, building, funding and placing each ring of the Circe Network into service.

We intend to sell capacity on the Circe Network. Revenue from capacity sales that qualify under generally accepted accounting principles to be treated as sales will be recognized under a line item to be titled "Capacity sales." Capacity sales will be recognized as revenue when the purchaser obtains the right to use the capacity. The related cost of capacity will be reported in the same period. With respect to each sale of capacity, the related cost of capacity sales will be equal to a proportionate amount of the total capitalized cost of the related network. Revenue from operating leases of private line circuits, which will be included in communications services revenue, will be recognized on a straight line basis over the life of the lease. The portion of the total capitalized cost of the Circe Network used to provide communications services will be included in property and equipment and charged to depreciation and amortization over its useful life.

We expect to trade capacity on the Circe Network for capacity on other cable systems. Depending upon structure, these trades of capacity may have a material effect on our statement of operations. We will incur sales and marketing related expenses that will not be capitalized and will affect our results of operations, particularly while the Circe Network is being designed, built and placed into service. In addition, we will continue to incur additional operating and maintenance expenses as the remaining phases of Circe become operational. As a result of financing the Circe Network with debt, we will capitalize a portion of the interest incurred that relates to the construction of the Circe Network until it is placed in service and will incur substantial increases in interest expense thereafter.

The Circe Network will have a beneficial effect on our costs of services as well as net income (loss). This will occur as we bring traffic "on-net," to facilities we own, as opposed to facilities that we lease from other carriers. A large portion of the expenses associated with facilities we own is accounted for as depreciation and amortization, while leased capacity is accounted for as a cost of services. As a result, we expect that our gross margins and profit will be improved as we bring traffic "on-net." However, our net income (loss) will not improve to the same extent. The effect of bringing traffic "on-net" will be somewhat delayed, because our leased line agreements require minimum notification to terminate our obligations.

RESULTS OF OPERATIONS

The following table summarizes the breakdown of our results of operations as a percentage of communication services revenue. Our total revenue, and therefore these percentages, could fluctuate substantially from period to period due to capacity sales, which have a substantially different impact on margins than communications services.

	1998	1997	1996
Communication revenue	100.0%	100.0%	100.0%
Cost of communication services	90.3%	87.0%	83.6%
Selling, general and administrative expenses	33.2%	49.4%	65.2%
Depreciation and amortization	12.0%	10.6%	9.5%
EBITDA loss (1)	(23.5%)	(36.4%)	(48.7%)

(1) As used herein "EBITDA" consists of earnings before interest, income taxes, extraordinary loss, dividends on convertible preferred stock and depreciation and amortization. EBITDA is a measure commonly used in the telecommunications industry to analyze companies on the basis of operating performance. EBITDA is not a measure of financial performance under generally accepted accounting principles, is not necessarily comparable to similarly titled measures of other companies and should not be considered as an alternative to net income as a measure of performance nor as an alternative to cash flow as a measure of liquidity.

1998 COMPARED TO 1997

COMMUNICATION SERVICES REVENUE

Communication services revenue increased by 85.1% to \$135.2 million on 383.9 million billable minutes for 1998 from \$73.0 million on 140.9 million billable minutes for 1997. Communication services revenue growth for 1998 was generated primarily from increased European retail traffic and growth in our carrier business in Western Europe and in North America which was partially offset by decreased revenue from our Pacific Rim and Latin American operations.

The overall increase of 172.4% in billable minutes from 1997 to 1998 was partially offset by declining revenue per billable minute, primarily because of (1) a higher percentage of lower-priced intra-European and national long distance traffic on our network as compared to intercontinental traffic, (2) a higher percentage of lower-priced carrier traffic as compared to retail traffic and (3) reductions in certain rates charged to retail customers in response to pricing reductions enacted by incumbent telecommunications operators and other carriers in many of our markets. See "— Cost of Communication Services."

Communication services revenue per billable minute from the sale of services to retail customers, which represented 41.7% of total communication services revenue for 1998, compared to 72.1% for 1997, decreased 43.5% in 1998 from 1997. Communication services revenue per billable minute from the sale of services to carriers and other resellers increased by 3.3% in 1998 from 1997 due primarily to changes in traffic mix. The number of contracted customers billed declined 30.2% to 15,010 at December 31, 1998 from 21,515 at December 31, 1997. This decline in contracted customers billed is primarily attributable to our Pacific Rim operations where the number of customers billed declined 93.2% to 369 at December 31, 1998 from 5,424 at December 31, 1997, representing a net loss of 5,055 customers, as a result of currency fluctuations caused by the Asian economic crisis, which made our rates noncompetitive.

During 1998 as compared to 1997, we significantly increased our carrier business through which we sell switched minutes, private lines and ports to carriers, Internet service providers and other resellers. The carrier business has enabled us to recover partially the costs associated with increased capacity in advance of demand from retail customers. The resulting economies of scale have allowed us to use our network more profitably for network originations and terminations within Europe. The carrier business represented approximately 58.3% of total communication services revenue and approximately 62.0% of billable minutes for 1998 as compared to approximately 27.9% of total communication services revenue and approximately 46.1% of billable minutes for 1997. The increase in communication services revenue derived from carriers and other resellers is partially attributable to the acquisition of Flat Rate Communications, Inc., a long distance telecommunications reseller, on February 27, 1998, which also significantly increased our North American revenues.

COST OF COMMUNICATION SERVICES

Cost of communication services increased to \$122.1 million in 1998 from \$63.5 million in 1997 and, as a percentage of communication services revenue, increased to approximately 90.3% from approximately 87.0%. Our gross margin decreased, as a percentage of communication services revenue, to 9.7% for 1998 from 13.0% for 1997. This decrease was primarily due to (1) decreased revenue per minute resulting from price competition and foreign currency fluctuations which was not offset by corresponding decreases in infrastructure costs, (2) increased sales to carrier customers which generate substantially lower margins, and (3) an increase in intra-European and national long distance traffic compared to higher margin international traffic. This decrease in gross margin, as a percentage of revenue, is one of the principal reasons we initiated a strategy to own key elements of our network infrastructure.

Cost of communication services increased in 1998 in part because of the relatively high cost of leased infrastructure. These costs are expected to decrease as a percentage of communication services revenue as we continue to migrate from leased to owned infrastructure. From 1997 to 1998, we increased our private line circuits capacity and, as a result, costs for private line circuits increased to approximately \$17.1 million for 1998 (approximately 12.6% of communication services revenue) from approximately \$9.6 million for 1997 (approximately 13.1% of communication services revenue).

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses increased to \$44.9 million in 1998 from \$36.1 million in 1997 and, as a percentage of communication services revenue, decreased to approximately 33.2% in 1998 from approximately 49.4% in 1997. Much of these expenses are attributable to overhead costs associated with our headquarters, back office and network operations as well as maintaining sales offices. Salaries and commissions, as a percentage of total selling, general and administrative expenses, were approximately 49.3% and 51.6% for 1998 and 1997, respectively. Advertising and promotion expenses, as a percentage of total selling, general and administrative expenses, were approximately 3.6% and 1.2% for 1998 and 1997, respectively. We expect to incur additional expenses as we continue to invest in our sales and marketing infrastructure and actively market our products and services.

EBITDA LOSS

EBITDA loss increased to \$31.8 million for 1998 from \$26.6 million for 1997. As a percentage of communication services revenue, EBITDA loss decreased to approximately 23.5% in 1998 from approximately 36.4% in 1997. These losses resulted from lower gross margins as a percentage of communication services revenue due to the relatively high cost of intra-European leased lines which was compounded by the impact on revenue of aggressive price reductions implemented by incumbent telecommunications operators.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization expense, which includes depreciation of our network, increased to approximately \$16.3 million in 1998 from approximately \$7.7 million in 1997. The increase was due primarily to (1) the depreciation of equipment related to network expansion and fiber optic cable systems placed in service during 1997 and (2) the amortization of goodwill associated with the acquisition of Fiat Rate Communications, Inc. in February 1998. Depreciation expense will increase substantially as each ring of the Circe Network becomes operational.

INTEREST

Interest expense increased to approximately \$79.2 million in 1998 from approximately \$12.5 million in 1997 primarily as a result of our high yield offering completed in April 1998. Interest income increased to approximately \$28.3 million for 1998 from approximately \$3.7 million in 1997 primarily as a result of the interim investment of the net proceeds from the 1998 high yield offering. During 1998, we capitalized \$3.3 million of interest costs.

1997 COMPARED TO 1996

COMMUNICATION SERVICES REVENUE

Communication services revenue increased by 44.8% to \$73.0 million on 140.9 million billable minutes for 1997 from \$50.4 million on 62.2 million billable minutes for 1996. Communication services revenue growth for 1997 was generated primarily from increased traffic volume on our network from growth in our carrier business and, to a lesser extent, increased traffic volume in Latin America and the Pacific Rim.

The overall increase of 126.4% in billable minutes from 1996 to 1997 was partially offset by declining revenue per billable minute, primarily because of (1) a higher percentage of lower-priced intra-European and national long distance traffic from our network as compared to intercontinental traffic, (2) a higher percentage of lower-priced carrier traffic as compared to retail traffic, (3) reductions in certain rates charged to retail customers in response to pricing reductions enacted by certain incumbent telecommunications operators and other carriers in many of our markets, (4) changes in customer access methods and (5) foreign currency fluctuations. See "— Cost of Communication Services."

Communication services revenue per billable minute from the sale of services to retail customers, which represented 72.1% of total communication services revenue in 1997, compared to 83.5% in 1996. Communication services revenue per billable minute from the sale of services to carriers and other resellers decreased from \$.38 in 1996 to \$.30 in 1997, primarily as a result of price competition. The number of customers billed rose 18.4% from 18,172 at December 31, 1996 to 21,515 at December 31, 1997.

The carrier business represented approximately 27.9% of total communication services revenue and approximately 46.1% of billable minutes for 1997 as compared to approximately 16.5% of total communication services revenue and approximately 35.2% of billable minutes for 1996. This increase in communication services revenue represents an increase of approximately 147.0% over 1996.

COST OF COMMUNICATION SERVICES

Cost of communication services increased to \$63.5 million in 1997 from \$42.1 million in 1996 and, as a percentage of communication services revenue, increased to approximately 87.0% from approximately 83.6% for 1997 and 1996, respectively. Our gross margin decreased to 13% for 1997 from 16.4% for 1996. This decrease was primarily due to (1) decreased revenue per minute resulting from price competition and foreign currency fluctuations which were not offset by corresponding decreases in infrastructure costs, (2) increased sales to carrier customers which generate substantially lower margins, and (3) an increase in intra-European and national long distance traffic compared to higher margin international traffic.

Cost of communication services increased in 1997 because of the relatively high cost of leased infrastructure and the accelerated rollout of European points of presence. These costs are expected to decrease as a percentage of communication services revenue as we continue our efforts to convert from leased to owned capacity. We increased our private line circuits capacity by 311%, and as a result the fixed costs associated with our network, costs for private line circuits increased to approximately \$6.0 million for 1997 (approximately 8.2% of communication services revenue) from approximately \$4.1 million for 1996 (approximately 8.2% of communication services revenue).

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses increased to \$36.1 million in 1997 from \$32.9 million in 1996 and, as a percentage of communication services revenue, decreased to approximately 49.4% in 1997 from approximately 65.2% in 1996. Much of these expenses are attributable to overhead costs associated with our headquarters, back office and network operations as well as maintaining a physical presence in seventeen different jurisdictions. Salaries and commissions, as a percentage of total selling, general and administrative expenses, were approximately 51.6% and 49.0% for 1997 and 1996, respectively.

EBITDA LOSS

EBITDA loss increased to \$26.6 million for 1997 from \$24.6 million for 1996. As a percentage of communication services revenue, EBITDA loss decreased to approximately 36.4% in 1997 from approximately 48.7% in 1996. These losses resulted from lower gross margins as a percentage of communication services revenue due to the relatively high cost of intra-European leased lines which was compounded by the impact on revenue of aggressive price reductions implemented by certain incumbent telecommunications operators.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization expense, which includes depreciation of our network, increased to approximately \$7.7 million in 1997 from approximately \$4.8 million in 1996. The increase was due primarily to the depreciation of equipment related to network expansion and fiber optic cable systems placed in service during 1997.

INTEREST

Interest expense increased to approximately \$12.5 million in 1997 from approximately \$10.8 million in 1996 due to the accretion of non-cash interest on the notes we issued in 1994. Interest income increased to approximately \$3.7 million in 1997 from approximately \$1.9 million for 1996, primarily as a result of the investment of the net proceeds from our initial public offering.

LIQUIDITY AND CAPITAL RESOURCES

We have incurred losses from operating activities in each year since our inception and expect to continue to incur operating and net losses for the next several years. Since inception, we have utilized cash provided by financing activities to fund operating losses, interest expense and capital expenditures. The sources of this cash have primarily been through private and public equity and debt financings and, to a lesser extent, equipment-based financing. In particular, in 1996 we raised \$104.0 million of gross proceeds (approximately \$94.5 million net proceeds) from the sale of our common stock, in 1998 we completed a high yield offering through which we raised approximately \$889.6 million of gross proceeds (approximately \$856.6 million of net proceeds) and in March 1999 we completed a high yield offering through which we raised \$365.5 million of gross proceeds (\$352.6 million of net proceeds). A portion of the proceeds from the 1998 high yield offering was utilized by us to retire our 15% Senior Discount Notes due 2005 pursuant to a tender offer. Additionally, a portion of the proceeds from the 1998 and 1999 high yield offerings was used to purchase securities which were pledged as security for certain of the interest payments on the notes. As of December 31, 1998, we had \$501.3 million of cash, cash equivalents and other liquid investments and \$144.5 million of restricted cash equivalents and other restricted investments which secure the interest payments on our outstanding high yield notes. Approximately \$78.2 million of the proceeds from the March 1999 offering was used to purchase government obligations which will be recorded as restricted investments in our first quarter financials.

We believe that the net proceeds from the April 1998 and the March 1999 high yield offerings, together with cash and marketable securities on hand and the sale of capacity on the Circe Network will provide sufficient funds for us to expand our business as planned and to fund operating losses for at least the next 12 to 18 months. However, the amount of our future capital requirements will depend on a number of factors, including the success of our business, the start-up dates of each ring of the Circe Network, the dates at which we further expand our network, the types of services we offer, staffing levels, acquisitions and customer growth, as well as other factors that are not within our control, including competitive conditions, government regulatory developments and capital costs. In addition, we continually discuss and evaluate potential acquisitions. In the event that (1) our plan or assumptions change or prove to be inaccurate, (2) we consummate an acquisition, (3) we are unable to convert from leased to owned infrastructure in accordance with our current plans or (4) the cash and investments on hand, and the proceeds from the sale of capacity on the Circe Network prove to be insufficient to fund our growth in the manner and at the rate currently anticipated, we may be required to delay or abandon some or all of our development and expansion plans or we may be required to seek additional sources of financing earlier than currently anticipated. In the event we are required to seek additional financing, there can be assurance that such financing will be available on acceptable terms or at all.

CAPITAL ADDITIONS — COMMITMENTS

The development of our business has required substantial capital. Capital additions for each period consist of capital expenditures, the net increase in property and equipment purchases payable, assets acquired under capital lease obligations and capitalized interest during the period. During 1998, capital additions totalled \$220.9 million and consisted of capital expenditures of approximately \$94.7 million, a net increase of \$92.5 million in property and equipment purchases payable, \$30.4 million of assets acquired under capital lease obligations and capitalized interest of \$3.3 million. We have also entered into certain agreements associated with the Circe Network, purchase commitments for network expansion and other items aggregating in excess of \$168.8 million at December 31, 1998. Additionally, we have minimum volume commitments to purchase transmission capacity from various domestic and foreign carriers aggregating approximately \$13.2 million for all of 1999.

FOREIGN CURRENCY

We have exposure to fluctuations in foreign currencies relative to the U.S. Dollar as a result of billing portions of our communication services revenue in the local European currency in countries where the local currency is relatively stable while many of our obligations, including a substantial portion of our transmission costs, are denominated in U.S. Dollars. In countries with less stable currencies, such as Brazil, we billed in U.S. Dollars. For 1998, approximately 45.4% of our communication services revenue was billed in various European currencies. Debt service on certain of the notes issued in our 1998 high yield offering are currently payable in Euros. A substantial portion of our capital expenditures are, and will continue to be, denominated in various European currencies, including the Euro. Most of the European currencies in which we do business converged effective January 1, 1999, with the exception of the British Pound Sterling.

With the continued expansion of our network, a substantial portion of the costs associated with the network, such as local access and termination charges and a portion of the leased line costs, as well as a majority of local selling expenses and debt service related to the Euro denominated notes, will be charged to us in the same currencies as revenue is billed. These developments create a natural hedge against a portion of our foreign exchange exposure. To date, much of the funding necessary to establish the local direct sales organizations has been derived from communication services revenue that was billed in local currencies. Consequently, we believe that our financial position as of December 31, 1998 and our results of operations for the year ended December 31, 1998 were not significantly impacted by fluctuations in the U.S. Dollar in relation to foreign currencies.

YEAR 2000

The Year 2000 problem is the result of computer programs, microprocessors and embedded date reliant systems using two digits rather than four to define the applicable year. If such programs are not corrected, such date sensitive computer programs, microprocessors and embedded systems may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in a system failure or miscalculation causing disruptions in operations.

In an effort to assess our Year 2000 state of readiness, during 1997 we began performing a complete inventory assessment of all of our internal systems, which we have divided into two categories, business essential, or mission critical, and support systems, or non-mission critical. As part of our Year 2000 program and as part of our overall procurement plan, we have sought to ensure that fixed assets acquired were Year 2000 compliant. At December 31, 1997, gross property and equipment was \$67.0 million compared to \$292.0 million at December 31, 1998, an increase of 335.5% in gross property and equipment. As part of this process, we have inventoried, tested, and ensured Year 2000 compliance of our mission critical systems. The inventory and testing of these mission critical systems is complete. The backbone of our communications network is primarily composed of Nortel switches which are Year 2000 compliant. Our message processing and billing systems, which are used to record and process millions of call detail records, and our transmission equipment, which are our only other mission critical systems, are also Year 2000 compliant. The majority of our non-mission critical systems are Year 2000 compliant. We anticipate our non-mission critical systems being Year 2000 compliant during the third quarter of 1999. The total estimated cost of ensuring our preparation for Year 2000 is approximately \$200,000, a portion of which has already been incurred and expensed.

We have initiated formal communications with the key carriers and other vendors on which our operations and infrastructure are dependent to determine the extent to which we are susceptible to a failure resulting from such third parties' inability to remediate their own Year 2000 problems. Accordingly, during the procurement process, we have taken steps to ensure that our vending, carriers and products purchased are Year 2000 compliant or are adequately addressing the Year 2000 issues. We can provide no assurance that the carriers and other vendors on which our operations and infrastructure rely are or will be Year 2000 compliant in a timely manner. Interruptions in the services provided to us by these third parties could result in disruptions in our services. Depending upon the extent and duration of any such disruptions and the specific services affected, such disruptions could have a material adverse affect on our business, financial condition and results of operations. As a contingency against any possible disruptions in services provided by vendors, we have sought to diversify our vendor base. We believe that the diversity of our vendor base is sufficient to mitigate Year 2000 related disruptions in service to our customers. In addition, we believe that the fact that we conduct business in, and derive revenue from, multiple Western European countries helps to mitigate the potential impact of Year 2000 related disruptions. In addition, disruptions in the economy generally resulting from Year 2000 problems could also have a material adverse affect on us. We could be subject to litigation resulting from any disruption in our services. The amount of potential liability or lost revenue which would result from these disruptions in service could have a material adverse effect on our business, financial condition and results of operations.

EURO

On January 1, 1999, eleven of the fifteen member countries of the European Union established irrevocable fixed conversion rates between their existing sovereign currencies and a single currency called the Euro. The sovereign currencies are scheduled to remain legal tender as denominations of the Euro during a transition period from January 1, 1999 to January 1, 2002.

We have completed an internal analysis regarding business and systems issues related to the Euro conversion and, as a result, made necessary modifications to our business processes and software applications. We are now able to conduct business in both Euro and sovereign currencies on a parallel basis, as required by the European Union.

We believe that the Euro conversion has not and will not have a significant impact on our business strategy in Europe. The costs to convert all systems to be Euro compliant did not have a significant impact on our results of operations.

INFLATION

We do not believe that inflation has had a significant effect on our operations to date.

PROSPECTIVE ACCOUNTING PRONOUNCEMENTS

Statement of Financial Accounting Standards No. 133 ("SFAS 133"), "Accounting for Derivative Instruments and Hedging Activities," was issued in June 1998. SFAS 133 standardizes the accounting for derivative instruments, including certain derivative instruments embedded in other contracts, by requiring recognition of those instruments as assets and liabilities and to measure them at fair value. While scheduled to be effective in the year 2000, there is a proposal to delay the implementation of the statement for one year. We have not completed our analysis of the impact of this statement on our financial statements.

MARKET RISK EXPOSURE

We are subject to foreign currency exchange rate risk relating to receipts from customers, payments to suppliers and interest payments on outstanding Euro denominated securities. We do not consider the market risk exposure relating to foreign currency exchange to be material. See "— Liquidity and Capital Resources — Foreign Currency."

We have financial instruments that are subject to interest rate risk, principally short-term investments and debt obligations issued at a fixed rate. Historically, we have not experienced material gains or losses due to interest rate changes when selling short-term investments and typically hold these securities until maturity. Based on our current holdings of short-term investments, our exposure to interest rate risk is not material. Fixed-rate debt obligations issued by us are generally not callable until maturity.

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders

Viatel, Inc.:

We have audited the accompanying consolidated balance sheets of Viatel, Inc. and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of operations, comprehensive loss, stockholders' equity (deficiency), and cash flows for each of the years in the three-year period ended December 31, 1998. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Viatel, Inc. and subsidiaries as of December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1998 in conformity with generally accepted accounting principles.

KPMG LLP

**Nineteen ninety-eight
was a pivotal year
for Viatel.**

CONSOLIDATED BALANCE SHEETS

Viatel, Inc. and Subsidiaries

December 31.

(In thousands, except share data)

1998

1997

ASSETS

Current Assets:

Cash and cash equivalents	\$ 329,511	\$ 21,096
Restricted cash equivalents	10,310	-
Restricted marketable securities, current	50,870	-
Marketable securities, current	171,771	3,500
Trade accounts receivable, net of allowance for doubtful accounts of \$3.093 and \$1.041, respectively	28,517	10,981
Other receivables	13,404	6,505
Prepaid expenses	2,417	1,348
Total current assets	<u>606,800</u>	<u>43,430</u>

Restricted marketable securities, non-current

83,343 -

Marketable securities, non-current

- 22,547

Property and equipment, net

266,256 54,094

Intangible assets, net

46,968 4,338

Other assets

5,744 2,400

\$1,009,111 \$ 126,809

LIABILITIES AND STOCKHOLDERS' DEFICIENCY

Current Liabilities:

Accrued telecommunications costs	\$ 26,518	\$ 16,898
Accounts payable and other accrued expenses	23,656	10,753
Property and equipment purchases payable	97,288	4,739
Accrued interest	12,240	-
Liability under joint construction agreement	9,523	-
Current installments of notes payable and obligations under capital leases	8,918	3,373
Total current liabilities	<u>178,143</u>	<u>35,763</u>

Long term liabilities:

Long term debt	896,503	89,855
Notes payable and obligations under capital leases, excluding current installments	24,636	8,255
Equipment purchase obligation	-	1,500
Total long term liabilities	<u>921,139</u>	<u>99,610</u>

Series A Redeemable Convertible Preferred Stock, \$.01 par value; authorized 718,042 shares; issued and outstanding 461,258 and no shares, respectively

47,121 -

Commitments and contingencies

Stockholders' deficiency:

Preferred Stock, \$.01 par value. Authorized 1,281,958 shares, no shares issued and outstanding	-	-
Common Stock, \$.01 par value. Authorized 50,000,000 shares, issued and outstanding 23,184,465 and 22,635,267 shares, respectively	232	226
Additional paid-in capital	128,357	125,661
Unearned compensation	-	(65)
Accumulated other comprehensive loss	(6,246)	(5,356)
Accumulated deficit	(259,635)	(129,030)
Total stockholders' deficiency	<u>(137,292)</u>	<u>(8,564)</u>
	<u>\$1,009,111</u>	<u>\$ 126,809</u>

CONSOLIDATED STATEMENTS OF OPERATIONS

Viatel, Inc. and Subsidiaries

Year Ended December 31.

(in thousands, except per share data)	1998	1997	1996
Communication services revenue	\$ 135,188	\$ 73,018	\$ 50,419
Operating expenses:			
Cost of communication services	122,109	63,504	42,130
Selling, general and administrative expenses	44,893	36,077	32,866
Depreciation and amortization	16,268	7,717	4,802
Total operating expenses	<u>183,270</u>	<u>107,298</u>	<u>79,798</u>
Other income (expenses):			
Interest income	28,259	3,686	1,852
Interest expense	(79,177)	(12,450)	(10,848)
Loss before extraordinary loss	(99,000)	(43,044)	(38,375)
Extraordinary loss on debt prepayment	(28,304)	-	-
Net loss	(127,304)	(43,044)	(38,375)
Dividends on redeemable convertible preferred stock	(3,301)	-	-
Net loss attributable to common stockholders	<u>\$ (130,605)</u>	<u>\$ (43,044)</u>	<u>\$ (38,375)</u>
Loss per common share, basic and diluted:			
Before extraordinary item	\$ (4.44)	\$ (1.90)	\$ (2.47)
From extraordinary item	(1.23)	-	-
Net loss attributable to common stockholders	<u>\$ (5.67)</u>	<u>\$ (1.90)</u>	<u>\$ (2.47)</u>
Weighted average common shares outstanding	<u>23,054</u>	<u>22,620</u>	<u>15,514</u>

See accompanying notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

Year Ended December 31.

(in thousands)	1998	1997	1996
STATEMENT OF OPERATIONS DATA:			
Net loss	\$ (127,304)	\$ (43,044)	\$ (38,375)
Foreign currency translation adjustments	(890)	(4,494)	(698)
Comprehensive loss	<u>\$ (128,194)</u>	<u>\$ (47,538)</u>	<u>\$ (39,073)</u>

See accompanying notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIENCY)

Viatel, Inc. and Subsidiaries

Years Ended December 31, 1998, 1997 and 1996
(In thousands, except share data)

	Number of Common Stock Shares	Number of Class A Common Stock Shares	Common Stock	Class A Common Stock	Additional Paid-In Capital	Unearned Compensation	Accumulated other Comprehensive Loss	Accumulated Deficit	Total
Balance at January 1, 1996	10,736,135	2,904,846	\$ 107	\$ 29	\$ 30,099	\$ (78)	\$ (164)	\$ (47,611)	\$ (17,618)
Issuance of restricted common stock	66,666	-	1	-	389	(52)	-	-	336
Issuance of common stock, net of \$9,541,954 issue costs	8,667,000	-	87	-	94,375	-	-	-	94,462
Conversion of Class A common stock to common stock	2,904,846	(2,904,846)	29	(29)	-	-	-	-	-
Stock options exercised	138,579	-	1	-	373	-	-	-	374
Foreign currency translation adjustment	-	-	-	-	-	-	(693)	-	(693)
Net loss	-	-	-	-	-	-	-	(38,375)	(38,375)
Balance at December 31, 1996	22,513,226	-	225	-	125,236	(130)	(862)	(85,986)	38,483
Stock options exercised	122,041	-	1	-	425	-	-	-	426
Earned compensation	-	-	-	-	-	65	-	-	65
Foreign currency translation adjustment	-	-	-	-	-	-	(4,494)	-	(4,494)
Net loss	-	-	-	-	-	-	-	(43,044)	(43,044)
Balance at December 31, 1997	22,635,267	-	226	-	125,661	(65)	(5,356)	(129,030)	(8,564)
Stock options exercised	174,198	-	2	-	945	-	-	-	947
Issuance costs of Series A Redeemable Convertible Preferred Stock	-	-	-	-	(1,620)	-	-	-	(1,620)
Issuance of common stock related to business purchase	375,000	-	4	-	3,371	-	-	-	3,375
Earned compensation	-	-	-	-	-	65	-	-	65
Foreign currency translation adjustment	-	-	-	-	-	-	(890)	-	(890)
Dividends on redeemable convertible preferred stock	-	-	-	-	-	-	-	(3,301)	(3,301)
Net loss	-	-	-	-	-	-	-	(127,304)	(127,304)
Balance at December 31, 1998	23,184,465	-	\$ 232	\$ -	\$ 128,357	\$ -	\$ (6,246)	\$ (259,635)	\$ (137,292)

CONSOLIDATED STATEMENTS OF CASH FLOWS

Viatel, Inc. and Subsidiaries

Year Ended December 31

(in thousands)	1998	1997	1996
Cash flows from operating activities:			
Net loss	\$ (127,304)	\$ (43,044)	\$ (38,375)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	16,268	7,717	4,802
Accreted interest expense on long term debt	35,417	12,479	10,763
Provision for losses on accounts receivable	4,225	2,733	2,225
Extraordinary loss on debt prepayment	28,304	-	-
Earned compensation	65	65	338
Changes in assets and liabilities:			
Increase in accounts receivable	(20,302)	(6,221)	(6,056)
Increase in accrued interest expense on Senior Notes	11,969	-	-
Increase in prepaid expenses and other receivables	(8,291)	(3,482)	(1,384)
Increase in other assets and intangible assets	(12,625)	(1,022)	(315)
Increase in accrued telecommunications costs, accounts payable and other accrued expenses	11,956	8,250	1,653
Net cash used in operating activities	(60,318)	(22,525)	(26,331)
Cash flows from investing activities:			
Purchase of property, equipment and software	(94,674)	(34,190)	(9,423)
Payment for business acquired excluding cash acquired of \$364	(5,000)	-	-
Purchase of marketable securities	(310,625)	(49,098)	(30,571)
Proceeds from maturity of marketable securities	60,307	40,124	38,807
Investment in affiliate	-	-	(102)
Issuance of notes receivable	-	-	(303)
Net cash used in investing activities	(349,992)	(43,164)	(1,592)
Cash flows from financing activities:			
Proceeds from issuance of long term debt	845,752	-	-
Proceeds from issuance of redeemable convertible preferred stock	42,198	-	-
Prepayment of senior discount notes	(119,282)	-	-
Deferred financing costs	(31,547)	-	-
Proceeds from issuance of Common Stock	947	426	94,836
Borrowings on notes payable	-	11,121	-
Payments under capital leases	(5,480)	(525)	(64)
Repayment of notes payable and bank credit line	(3,553)	(336)	-
Borrowings under bank credit line	-	600	-
Net cash provided by financing activities	729,035	11,286	94,772
Effects of exchange rate changes on cash	-	(297)	12
Net (decrease) increase in cash and cash equivalents	318,725	(54,700)	66,861
Cash and cash equivalents at beginning of year	21,096	75,796	8,935
Cash and cash equivalents at end of year	\$ 339,821	\$ 21,096	\$ 75,796
Supplemental disclosures of cash flow information:			
Interest paid	\$ 31,560	\$ 134	\$ 65
Assets acquired under capital lease obligations	\$ 30,359	\$ 1,122	\$ 310

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1998, 1997 and 1996

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(A) DESCRIPTION OF BUSINESS

Viatel, Inc. (the "Company") is an international facilities-based global provider of communications services offering international and domestic long distance telecommunications services, primarily to small and medium-sized businesses, carriers and resellers. The Company operates a pan-European communication network with international gateway switching centers in New York and London and network points of presence throughout Western Europe. The Company is constructing a fiber optic ring which will connect five European countries (the "Circe Network").

(B) PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant inter-company balances and transactions have been eliminated in consolidation. Investments in affiliates in which the Company has significant influence but does not exercise control are accounted for under the equity method.

(C) CASH AND CASH EQUIVALENTS

The Company's policy is to maintain its uninvested cash at minimum levels. Unrestricted cash equivalents, which include highly liquid debt instruments purchased with a maturity of three months or less, were \$278.9 million and \$8.2 million at December 31, 1998 and 1997, respectively.

(D) REVENUE

The Company records communication services revenue as earned, at the time services are provided. Network capacity sales are recorded at the time the capacity is provided to the customer.

(E) PROPERTY AND EQUIPMENT

Property and equipment consist principally of telecommunications related equipment such as switches, fiber optic cable systems, remote nodes and related computer software and is stated at cost. Assets acquired under capital leases are stated at the present value of the future minimum lease payments. Maintenance and repairs are expensed as incurred.

Depreciation is provided using the straight-line method over the estimated useful lives of the related assets. Leasehold improvements are amortized over the life of the lease or useful life of the improvement, whichever is shorter. The estimated useful lives are as follows:

Communications systems	5 to 7 years
Fiber optic cable systems	15 years
Leasehold improvements	2 to 5 years
Furniture, equipment and other	5 years

(F) INTANGIBLE ASSETS

Deferred financing and registration fees represent costs incurred to issue and register debt and are being amortized over the term of the related debt.

Licenses issued by governing bodies are being amortized over the lesser of 25 years or the term of the license.

Goodwill, which represents the excess of purchase price over fair value of net assets acquired, is amortized on a straight-line basis over the expected periods to be benefitted, five to seven years.

Acquired employee base and sales force in place represents the intangible assets associated with the acquisition of independent sales organizations and is being amortized over three years.

The costs of all other intangible assets are being amortized over their useful lives, ranging from three to seven years.

(G) INCOME TAXES

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income or expense in the period it occurs.

(H) FOREIGN CURRENCY TRANSLATION

Foreign currency assets and liabilities are translated using the exchange rates in effect at the balance sheet date. Results of operations are translated using the average exchange rates prevailing throughout the year. The effects of exchange rate fluctuations on translating foreign currency assets and liabilities into U.S. dollars are accumulated as part of the foreign currency translation adjustment in stockholders' equity. Gains and losses from foreign currency transactions are included in selling, general and administrative expenses in the period in which they occur. For the years ending December 31, 1998, 1997 and 1996, the Company experienced no material exchange transaction gains or losses.

(I) NET LOSS PER SHARE

Basic earnings per share ("EPS") is computed by dividing income or loss attributable to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution from the exercise or conversion of securities into common stock.

Net loss and weighted average shares outstanding used for computing diluted loss per common share were the same as that used for computing basic loss per common share for each of the years ended December 31, 1998, 1997 and 1996.

The Company had potentially dilutive common stock equivalents of 7.2 million, 1.1 million and 1.0 million for the years ended December 31, 1998, 1997 and 1996, respectively. These common stock equivalents were not included in the computation of diluted net loss per common share because they were antidilutive for the periods presented.

(J) CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject the Company to concentration of credit risk consist primarily of temporary cash investments and trade receivables. The Company restricts investment of temporary cash investments to financial institutions with high credit standing. The Company does not believe there is any concentration of credit risk on trade receivables as a result of the large and diverse nature of the Company's worldwide customer base.

During 1998, one customer, LD Exchange.com, accounted for 10.6% of the Company's revenues.

(K) RECLASSIFICATIONS

Certain reclassifications have been made to the prior years' financial statements to conform to the current year's presentation.

(L) USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

(M) ADDITIONAL ACCOUNTING POLICIES

Additional accounting policies are incorporated into the notes herein.

(N) STOCK OPTION PLAN

The Company accounts for its stock option plan in accordance with Statement of Financial Accounting Standards ("SFAS") No. 123 which allows entities to continue to apply the provisions of Accounting Principles Board ("APB") Opinion No. 25 and provide pro forma net income and pro forma earnings per share disclosures for employee stock option grants made in 1995 and future years as if the fair-value-based method, as defined in SFAS No. 123, had been applied. The Company has elected to apply the provisions of APB Opinion No. 25 and provide the pro forma disclosure required by SFAS No. 123. See Note 12.

(O) IMPAIRMENT OF LONG-LIVED ASSETS AND LONG-LIVED ASSETS TO BE DISPOSED OF

Long-lived assets and certain identifiable intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceed the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

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(2) INVESTMENTS IN DEBT SECURITIES

Management determines the appropriate classification of its investments in debt securities at the time of purchase and classifies them as held to maturity or available for sale. These investments are diversified among high credit quality securities in accordance with the Company's investment policy. Debt securities that the Company has both the intent and ability to hold to maturity are carried at amortized cost. Debt securities for which the Company does not have the intent or ability to hold to maturity are classified as available for sale. Securities available for sale are carried at fair value, with the unrealized gains and losses, net of tax, reported in a separate component of stockholders' equity. The Company does not invest in securities for the purpose of trading and as such does not classify any securities as trading.

The cost of debt securities classified as held to maturity are adjusted for amortization of premiums and accretion of discounts to maturity over the estimated life of the security. Such amortization and accretion are included in interest income. There were no securities classified as available for sale as of December 31, 1998 and no securities classified as held to maturity as of December 31, 1997.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is a summary of the amortized cost, which approximates fair value of restricted securities held to maturity at December 31, 1998 (in thousands):

U.S. Treasury obligations	\$ 105,508
German government obligations	28,705
Total	<u>\$ 134,213</u>

The following is a summary of the amortized cost, which approximates fair value of securities held to maturity at December 31, 1998 (in thousands):

European corporate debt securities	\$ 122,299
U.S. corporate debt securities	49,472
Total	<u>\$ 171,771</u>

The following is a summary of the fair value of securities available for sale at December 31, 1997 (in thousands):

U.S. Treasury obligations	\$ 2,028
Corporate debt securities	13,482
Federal agencies obligations	10,537
Total	<u>\$ 26,047</u>

Unrealized gains or losses on securities classified as available for sale are not material at December 31, 1997.

The amortized cost, which approximates fair value, of restricted securities held to maturity at December 31, 1998 are shown below (in thousands):

Due within one year	\$ 50,870
Due after one year through two years	54,328
Due after two years	29,015
Total	<u>\$ 134,213</u>

There were no changes in the classification of any securities held to maturity or securities available for sale from the time of purchase to the time of maturity or sale.

(3) PROPERTY AND EQUIPMENT

Property and equipment consists of the following as of December 31 (in thousands):

	1998	1997
Communications system	\$ 70,971	\$ 43,322
Construction in progress	172,630	10,094
Fiber optic cable systems	25,222	1,432
Furniture, equipment and other	16,450	8,924
Leasehold improvements	6,651	3,254
	<u>291,924</u>	<u>67,026</u>
Less accumulated depreciation and amortization	25,668	12,932
	<u>\$ 266,256</u>	<u>\$ 54,094</u>

At December 31, 1998, construction in progress represents construction of the Circe Network. At December 31, 1997, construction in progress represents a portion of the expansion of the Company's European network. For the years ended December 31, 1998, 1997 and 1996, \$3.3 million, \$0.2 million and \$0.1 million of interest was capitalized.

The Company trades indefeasible rights-of-use or capacity on the Circe Network for indefeasible rights-of-use or capacity on other cable systems. These trades of indefeasible rights-of-use or capacity are accounted for as non-monetary exchanges and did not have a material effect on the Company's statement of operations.

At December 31, 1998, the Company has entered into a letter of intent with Metromedia Fiber Networks, Inc. and Carrier 1, Inc. to jointly construct the civil works associated with a national communications network being constructed by each party in Germany. As part of the letter of intent, Metromedia Fiber Networks, Inc. and Carrier 1, Inc. were required to place in escrow with the Company an amount

of \$9.3 million which is included in restricted cash equivalents in the accompanying consolidated balance sheets. In February, 1999, the parties entered into a definitive agreement which required each party to supply a standby letter of credit to cover the construction costs related to their portion of the network.

(4) INTANGIBLE ASSETS

Intangible assets consist of the following as of December 31 (in thousands):

	1998	1997
Deferred financing and registration costs	\$ 31,547	\$ 3,789
Licenses, trademarks and servicemarks	10,031	464
Goodwill	8,744	474
Purchased software	1,859	1,494
Acquired employee base and sales force in place	-	1,607
Other	206	385
	<u>52,387</u>	<u>8,213</u>
Less accumulated amortization	<u>5,419</u>	<u>3,875</u>
	<u>\$ 46,968</u>	<u>\$ 4,338</u>

(5) ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consists of the following as of December 31 (in thousands):

	1998	1997
Accounts payable	\$ 5,566	\$ 6,231
Accrued expenses	16,224	3,253
Accrued compensation and benefits	1,866	1,269
	<u>\$ 23,656</u>	<u>\$ 10,753</u>

(6) LINE OF CREDIT AND LETTERS OF CREDIT

The Company has a revolving line of credit agreement which provides for secured borrowings of up to \$11.2 million. Borrowings under this line of credit agreement can be made under either of the following interest rate formulas: (i) the lending institution's prime rate or (ii) the LIBOR rate plus two hundred basis points. The Company had no borrowings under the line of credit agreement at December 31, 1998 and \$0.6 million in borrowings under the line of credit agreement at December 31, 1997. The terms of the line of credit agreement include, among other provisions, requirements for maintaining defined levels of securities and other liquid collateral. At December 31, 1998, standby letters of credit of approximately \$3.3 million have been issued under this line of credit agreement.

In connection with the Company's joint construction of the civil works associated with national communications networks being constructed by each party in Germany, in February 1999 the Company was required to obtain a letter of credit of approximately \$123 million (DM219.1 million) in support of its obligations.

The weighted-average interest rate on short-term borrowings under the line of credit agreement at December 31, 1997 was 8.0%.

(7) LONG TERM LIABILITIES AND REDEEMABLE CONVERTIBLE PREFERRED STOCK

(A) LONG TERM DEBT AND REDEEMABLE CONVERTIBLE PREFERRED STOCK

On April 8, 1998, the Company completed an offering of units (the "Units Offering") consisting of senior notes or senior discount notes due 2008 and shares of 10% Series A Redeemable Convertible Preferred Stock due 2010 ("Series A Preferred"), \$.01 par value per share, of the Company and units consisting of senior notes or senior discount notes due 2008 and subordinated convertible debentures due 2011 (the "Subordinated Debentures") through which it raised approximately \$889.6 million of gross proceeds (\$856.6 million of net proceeds). The Company utilized \$118.9 million of the proceeds from the Units Offering to retire its 15% Senior Discount Notes due 2005 resulting in an extraordinary loss of \$28.3 million. Additionally, a portion of the proceeds from the Units Offering were used to purchase approximately \$122.8 million of U.S. government securities which were pledged as security for the first six interest payments on the U.S. dollar denominated senior notes and approximately \$30.6 million of German government obligations which were pledged as security for the first six interest payments on the Deutsche Mark denominated senior notes issued in the Units Offering. The senior discount notes accrete through April 15, 2003 and interest becomes payable in cash in semi-annual installments thereafter. The interest on the senior notes is payable in semi-annual installments. The Series A Preferred and the Subordinated Debentures require quarterly payments which are paid in additional securities, cash or any combination thereof through April 15, 2003 and payable in cash thereafter. The Series A Preferred and the Subordinated Debentures are mandatorily convertible in the event the closing price of the Company's common stock, \$.01 par value per share (the "Common Stock"), exceeds certain predetermined annual price targets. The Series A Preferred and Subordinated Debentures conversion rates are \$13.20 and DM24.473 (\$14.58), respectively. In addition, the terms of the Series A Preferred and Subordinated Debentures provide for special dividends and special interest payments, respectively, under certain conditions.

The indentures pursuant to which the senior notes and the senior discount notes were issued contain certain covenants that, among other things, limit the ability of the Company to incur additional indebtedness, pay dividends or make certain other distributions, enter into transactions with stockholders and affiliates and create liens on its assets. In addition, upon a change of control, the Company is required to make an offer to purchase the senior notes and the senior discount notes at a purchase price equal to 101% of the principal amount, in the case of the senior notes, and 101% of the accreted value of the notes, in the case of the senior discount notes. The indenture pursuant to which the Subordinated Debentures were issued also requires that the Company offer to repurchase the debentures at 101% of the principal amount in the event of a change of control.

On September 30, 1998, the Company consummated an offer to exchange senior notes and senior discount notes due 2008 which have been registered under the Securities Act of 1933, as amended, for outstanding notes of each such series which were not registered under the Securities Act of 1933, as amended.

Long term debt consists of the following as of December 31 (in thousands):

	1998	1997
11.25% Senior Notes	\$ 400,000	\$ -
11.15% Senior Notes (DM178,000)	106,015	-
12.50% Senior Discount Notes, less discount of \$202,716	297,284	-
12.40% Senior Discount Notes (DM134,916), less discount of \$54,249 (DM91,084)	80,355	-
10% Subordinated Convertible Debentures (DM 21,573)	12,849	-
15% Senior Discount Notes, less discount of \$30,845	-	89,855
	<u>\$ 896,503</u>	<u>\$ 89,855</u>

(B) EQUIPMENT FINANCING

In November and December 1997, the Company entered into Loan and Security Agreements, as amended, with Charter Financial, Inc. ("Charter") pursuant to which the Company borrowed an aggregate of \$11.1 million, of which \$7.8 million was outstanding as of December 31, 1998. Repayment of these loans commenced in December 1997 and January 1998 and are repayable in thirty-two or thirty-six successive monthly installments, respectively. Under the terms of these arrangements, the Company is required to satisfy certain EBITDA and unrestricted cash requirements. As of December 31, 1998, the Company was either in compliance with, or had received waivers to, these covenants. Obligations under these Loan and Security Agreements are secured by the grant to Charter of a security interest in certain designated telecommunications equipment. A portion of the payment obligations under these borrowing arrangements are also secured by letters of credit.

(8) STOCKHOLDERS' EQUITY

On October 23, 1996, the Company completed an initial public offering ("IPO") of its Common Stock, through which it sold 8,667,000 shares of Common Stock at \$12 a share and raised approximately \$104 million of gross proceeds (\$94.5 million of net proceeds).

In connection with the IPO, all shares of then Class A Common Stock were converted into shares of Common Stock at a ratio of one-to-one and all then outstanding shares of Common Stock were subject to a reverse stock split at a ratio of 3-to-2. In addition, the Company's stockholders approved an amendment to the Company's Certificate of Incorporation which (i) authorized the Board of Directors to issue up to two million shares of Preferred Stock, \$.01 par value per share, of which no shares were issued and outstanding at December 31, 1996, in one or more series and to fix the powers, voting rights, designations and preferences of each series and (ii) eliminated the Class A Common Stock.

All earnings per share and share data presented herein reflect the conversion of the Class A Common Stock into Common Stock and the reverse stock split of all then outstanding shares of Common Stock.

(9) ACQUISITION

On February 27, 1998, the Company acquired Flat Rate Communications, Inc. ("Flat Rate"), a long distance telecommunications reseller, for \$5.0 million of cash, 375,000 shares of the Common Stock and a contingent payment based upon key operating performance targets for the twelve month period ending February 28, 1999 which will range from zero to \$21.0 million in cash and zero to 1.0 million shares of Common Stock. The Company recorded the acquisition under the purchase method of accounting. The purchase price has been allocated to the assets acquired and liabilities assumed, based upon the estimated fair values at the date of acquisition. The excess purchase price was \$8.3 million and will be amortized on a straight line basis over a five-year period. If the acquisition had occurred on January 1, 1996 (i) communication services revenue for the years 1998, 1997 and 1996 would have been \$138.5 million, \$101.8 million and \$53.4 million, respectively, (ii) loss before extraordinary loss for 1998 would have been \$(98.9) million, (iii) net loss applicable to common stockholders for the years 1998, 1997 and 1996 would have been \$(130.5) million, \$(42.8) million and \$(38.5) million, respectively, and (iv) net loss per common share for the years 1998, 1997 and 1996 would have been \$(5.65), \$(1.86) and \$(2.43), respectively.

(10) INCOME TAXES

The statutory Federal tax rates for the years ended December 31, 1998, 1997 and 1996 were 35%. The effective tax rates were zero for the years ended December 31, 1998, 1997 and 1996 due to the Company incurring net operating losses for which no tax benefit was recorded.

For Federal and foreign income tax purposes, the Company has unused net operating loss carryforwards of approximately \$218.8 million expiring in 2007 through 2018. The availability of the net operating loss carryforwards to offset income in future years is restricted as a result of the Company's issuance of its Common Stock and may be further restricted as a result of future sales of Company stock and other events.

The tax effect of temporary differences that give rise to significant portions of the deferred tax assets are as follows (in thousands):

December 31,	1998	1997
Accounts receivable principally due to allowance for doubtful accounts	\$ 1,506	\$ 587
OID interest not deductible in current period	11,125	11,149
Federal net operating loss carryforwards	68,579	29,093
Foreign net operating loss carryforwards	7,989	3,777
Total gross deferred tax assets	89,199	44,606
Less valuation allowance	(89,199)	(44,606)
Net deferred tax assets	\$ -	\$ -

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning in making these assessments. During 1998 and 1997, the valuation allowance increased by \$44.6 million and \$14.7 million, respectively.

(11) SEGMENT AND GEOGRAPHIC DATA

All of the Company's operations are in a single industry segment, communications services. While the Company's chief decision maker monitors the revenue streams of the various products and geographic locations, operations are managed and financial performance is evaluated based on the delivery of multiple, integrated services to customers over a single network. As a result, there are many shared expenses generated by the various revenue streams and management believes that any allocation of the expenses incurred to multiple revenue streams or geographic locations would be impractical and arbitrary. Management does not currently make such allocations internally.

The Company groups its products and services by two customer types, wholesale and retail. The information below summarizes communication services revenue by customer type (in thousands):

	1998	1997	1996
Wholesale	\$ 78,777	\$ 20,397	\$ 9,516
Retail	56,411	52,621	40,903
Consolidated	\$ 135,188	\$ 73,018	\$ 50,419

The information below summarizes communication services revenue by geographic area (in thousands):

	1998	1997	1996
Western Europe	\$ 62,946	\$ 32,647	\$ 19,917
North America	56,172	15,936	9,516
Latin America	14,653	16,240	14,402
Asia/Pacific Rim and other	1,417	8,195	6,584
Consolidated	\$ 135,188	\$ 73,018	\$ 50,419

The information below summarizes long lived assets by geographic area (in thousands):

	1998	1997
Western Europe	\$ 237,443	\$ 32,640
North America	75,492	25,626
Latin America	289	166
Consolidated	\$ 313,224	\$ 58,432

(12) STOCK OPTION PLAN

During 1993, the Board of Directors approved the 1993 Flexible Stock Incentive Plan, as amended (the "Stock Incentive Plan") under which "non-qualified" stock options ("NQSOs") to acquire shares of Common Stock may be granted to employees, directors and consultants of the Company and "incentive" stock options ("ISOs") to acquire shares of Common Stock may be granted to employees including non-employee directors. The Stock Incentive Plan also provides for the grant of stock appreciation rights ("SARs") and shares of restricted stock to the Company's employees, directors and consultants.

The Stock Incentive Plan provides for the issuance of up to a maximum of 4,166,666 shares of Common Stock and is currently administered by the Compensation Committee of the Board of Directors. Under the Stock Incentive Plan, the option price of any ISO may not be less than the fair market value of a share of Common Stock on the date on which the option is granted. The option price of an NQSO may be less than the fair market value on the date the NQSO is granted if the Board of Directors so determines. An ISO may not be granted to a "ten percent stockholder" (as such term is defined in Section 422A of the Internal Revenue Code) unless the exercise price is at least 110% of the fair market value of the Common Stock and the term of the option may not exceed five years from the date of grant. Common Stock subject to a restricted stock purchase or bonus agreement is transferable only as provided in such agreement. The maximum term of each stock option granted to persons other than ten percent stockholders is ten years from the date of grant.

The per share weighted average fair value of stock options granted during 1998, 1997 and 1996 was \$6.40, \$5.99 and \$2.29, respectively, on the date of grant using the Black-Scholes option pricing model with the following assumptions: (1) a risk free interest rate of 5.0% in 1998 and 5.5% in 1997 and 1996, (2) an expected life of 10 years for all years, (3) volatility of approximately 92.7% for 1998, 52.2% for 1997 and 35.9% for 1996 and (4) an annual dividend yield of 0% for all years.

The Company applies the provisions of APB Opinion No. 25 in accounting for its Stock Incentive Plan and, accordingly, no compensation cost has been recognized for its stock options in the financial statements since the exercise price was equal to or greater than the fair market value at the date of grant. Had the Company determined compensation cost based on the fair value at the grant date for its stock options under SFAS No. 123, the Company's net loss would have been increased to the pro forma amounts indicated below:

	1998	1997	1996
Net loss, as reported (in thousands)	\$ (130,605)	\$ (43,044)	\$ (38,375)
Net loss, pro forma (in thousands)	(135,458)	(44,171)	(38,986)
Net loss per common share, as reported	(5.67)	(1.90)	(2.47)
Net loss per common share, pro forma	(5.88)	(1.95)	(2.51)

Pro forma net loss reflects only options granted since January 1, 1995. Therefore, the full impact of calculating compensation cost for stock options under SFAS No. 123 is not reflected in the pro forma net loss amounts because compensation cost is reflected over the options' vesting period of three years and compensation cost for options granted prior to January 1, 1995 is not considered.

Stock option activity under the Stock Incentive Plan is shown below:

	Weighted Average Exercise Prices	Number of Shares (in thousands)
Outstanding at January 1, 1996	\$ 4.01	474
Granted	6.75	823
Forfeited	5.77	(188)
Exercised	2.70	(139)
Outstanding at December 31, 1996	6.18	970
Granted	8.61	428
Forfeited	6.68	(197)
Expired	5.46	(27)
Exercised	3.49	(122)
Outstanding at December 31, 1997	7.40	1,052
Granted	7.19	1,794
Forfeited	7.14	(64)
Expired	5.05	(14)
Exercised	5.44	(174)
Outstanding at December 31, 1998	\$ 7.41	2,594

The following table summarizes weighted-average option exercise price information:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding at December 31, 1998 (in thousands)	Weighted Average Remaining Life	Weighted Average Exercise Price	Number Exercisable at December 31, 1998 (in thousands)	Weighted Average Exercise Price
\$ 0.75 - \$ 3.50	2	5 Years	\$ 0.75	2	\$ 0.75
3.51 - 5.75	999	9 Years	5.22	19	3.74
5.76 - 8.75	552	8 Years	6.17	291	5.90
8.76 - 12.00	1,041	9 Years	10.13	148	10.22
	<u>2,594</u>		<u>\$ 7.41</u>	<u>460</u>	<u>\$ 7.18</u>

Prior to the adoption of the Stock Incentive Plan, 5,913 options were granted. These options were exercised at \$0.75 per share during the year ended December 31, 1996.

The exercise price of all options approximates the fair market value of the Common Stock on the date of grant.

In addition, prior to the adoption of the Stock Incentive Plan, the Board of Directors authorized the issuance of up to 233,333 shares of Common Stock as compensation to employees and consultants of the Company of which 219,639 are available for issuance at December 31, 1998.

(13) COMMITMENTS AND CONTINGENCIES

(A) LEASES

At December 31, 1998, the Company was committed under non-cancelable operating and capital leases for the rental of office space, network locations and fiber optic cable systems.

The Company's future minimum capital and operating lease payments are as follows (in thousands):

	Capital	Operating
1999	\$ 6,890	\$ 3,917
2000	6,952	4,277
2001	4,372	4,206
2002	1,635	4,263
2003	1,635	4,231
Thereafter	32,692	28,853
	<u>\$ 54,176</u>	<u>\$ 49,747</u>
Less interest costs	<u>\$ 28,453</u>	
	<u>\$ 25,723</u>	

Total rent expense amounted to \$1.8 million, \$1.3 million and \$1.5 million for the years ended December 31, 1998, 1997 and 1996, respectively.

(B) CARRIER CONTRACTS

The Company has entered into contracts to purchase transmission capacity from various domestic and foreign carriers. By committing to purchase minimum volumes of transmission capacity from carriers, the Company is able to obtain guaranteed rates which are more favorable than those generally offered in the marketplace. The minimum volume commitments are approximately \$13.2 million for the year ending December 31, 1999. The Company is involved in disputes with carriers arising in the ordinary course of business. The Company believes the outcome of all current disputes will not have a material effect on the Company's financial position or results of operations.

(C) PURCHASE COMMITMENTS

The Company is continually upgrading and expanding its network and its switching facilities. In connection therewith, the Company has entered into purchase commitments to expend approximately \$38.2 million.

The Company is developing a fiber-optic ring which will connect over 30 cities in Western Europe (the "Circe Network"). In connection with the Circe Network, the Company has entered into purchase commitments to expend approximately \$130.6 million.

(D) EMPLOYMENT CONTRACTS

The Company has employment contracts with certain officers at amounts generally equal to such officers' current levels of compensation. The Company's remaining commitments at December 31, 1998 for the next three years under such contracts aggregates approximately \$1.4 million.

(E) LITIGATION

From time to time, the Company is subject to litigation in the normal course of business. The Company believes that any adverse outcome from litigation would not have a material adverse effect on its financial position or results of operations.

(14) REGULATORY MATTERS

The Company is subject to regulation in countries in which it does business. The Company believes that an adverse determination as to the permissibility of the Company's services under the laws and regulations of any such country would not have a material adverse long-term effect on its business.

(15) RELATED PARTY TRANSACTIONS

During 1998, the Company entered into an agreement with Cignal Global Communications, Inc. ("Cignal"), pursuant to which the Company sold transatlantic capacity. Consideration received was in the form of 650,000 shares of Cignal's common stock. The Company recognized \$3.25 million of revenue, the fair value of the transatlantic capacity. In addition, the Company agreed to sell capacity on the Circe Network in exchange for an additional 350,000 shares of Cignal's common stock. Pending delivery of the capacity to Cignal, these 350,000 shares are being held in escrow. The Company's Chairman and Chief Executive Officer is a director of Cignal.

On June 3, 1998, the Company entered into a Mutual Cooperation Agreement with Martin Varsavsky, a greater than ten percent stockholder of the Company, and Jazz Telecom S.A. pursuant to which the parties made certain agreements including the following: (1) subject to Jazz Telecom S.A. completing a high yield offering with net proceeds to Jazz Telecom S.A. of at least \$100 million (the "Offering Condition"), the Company and Jazz Telecom S.A. agreed to use commercially reasonable efforts to execute and deliver a construction agreement no later than January 1, 1999 to construct a fiber optic submarine cable system between Spain and the United Kingdom, (2) subject to the Offering Condition, the Company agreed to purchase \$6.0 million of Jazz Telecom S.A. common stock, (3) the Company and Jazz Telecom S.A. agreed to the purchase from the other international switched minutes and to transmit at least one-third of the Company's Spanish domestic switched minute traffic over Jazz Telecom S.A.'s network, assuming the prices charged by Jazz Telecom S.A. are competitive, (4) the Company and Jazz Telecom S.A. agreed to sell capacity to each other for fixed prices, (5) Mr. Varsavsky agreed to lock-up his Company shares for a specified period, (6) the Company agreed to release any past claims which the Company had against either Jazz Telecom S.A. and Mr. Varsavsky in exchange for their respective release of any claims against the Company and (7) Mr. Varsavsky agreed to pay the Company liquidated damages in the event that he violates certain provisions of the agreement. The Company and Jazz Telecom S.A. are currently in discussions to certain modifications to the terms of the Mutual Cooperation Agreement.

On November 13, 1998, Mr. Varsavsky entered into an additional lock-up agreement with the Company pursuant to which Mr. Varsavsky agreed that he would not sell, contract to sell, announce an intention to sell, pledge or otherwise dispose of his shares of the Company's common stock, either directly or indirectly, without the prior written consent of the Company until after August 12, 1999.

(16) SUBSEQUENT EVENT — UNAUDITED

On March 19, 1999, the Company completed a \$365.5 million offering of debt securities consisting of \$200 million of U.S. denominated 11.50% Senior Notes Due 2009 and \$165 million Euro denominated 11.50% Senior Notes Due 2009. The net proceeds from the sale of these notes will be used primarily to fund the further expansion of the Circe Network into southern France and Switzerland.

MARKET FOR VIATEL'S COMMON STOCK

Our common stock is quoted on the Nasdaq Stock Market under the symbol "VYTL." As of July 16, 1999, there were approximately 32.6 million shares of common stock issued and outstanding, held by approximately 8,500 holders. The following table sets forth, for each of the periods indicated, the high and low sales prices per share of common stock as reported on the Nasdaq National Market.

1997	High	Low	1998	High	Low
First Quarter	\$ 9 1/2	\$ 6 5/8	First Quarter	\$ 13 3/4	\$ 5
Second Quarter	7	6	Second Quarter	17	7
Third Quarter	6 5/8	4 1/4	Third Quarter	20 3/4	8 1/8
Fourth Quarter	7	5	Fourth Quarter	23 1/2	7 1/4

On July 16, 1999, the reported last sale price of our common stock on the Nasdaq National Market was 54 7/8 per share.

We have not paid any dividends on our common stock and do not intend to pay any dividends on our common stock in the foreseeable future. We currently intend to retain future earnings, if any, to finance the future growth of our business. In addition, our ability to pay cash dividends is currently restricted under the terms of the indentures related to our existing senior indebtedness. Future dividends, if any, will be determined by our Board of Directors.

Corporate Information

VIATEL DIRECTORS

Michael J. Mahoney
Chairman, President and
Chief Executive Officer

Allan L. Shaw
Senior Vice President, Finance
and Chief Financial Officer

Paul G. Pizzani
Partner at eVentures LLC

John G. Graham
President and Chief Operating
Officer of Utilities Mutual
Insurance Company

Francis J. Mount
Senior Vice President,
Engineering and
Network Operations

VIATEL EXECUTIVE OFFICERS

Michael J. Mahoney
Chairman, President and
Chief Executive Officer

Allan L. Shaw
Senior Vice President, Finance
and Chief Financial Officer

Lawrence G. Malone
Senior Vice President,
Global Sales and Marketing

Sheldon M. Goldman
Senior Vice President,
Business Affairs and
General Counsel

Francis J. Mount
Senior Vice President,
Engineering and
Network Operations

Glenn K. Davidson
Vice President, Corporate
Communications and
External Affairs

Charles T. Field
Vice President,
Finance and Treasurer

Derek Foxwell
Vice President,
Infrastructure Programs

Simon Jolyon Gilling
Vice President, European
Legal Affairs

Paul K. Heun
Vice President,
Operations – North America

Fred Hughes
Vice President, Engineering

Evan Miller
Vice President, Business
Development

Wayne Myers
Vice President, European Sales

Jan S. Piazza
Vice President, Carrier Sales

Ellen S. Rudin
Vice President and
Deputy General Counsel

Peter Stephens
Vice President,
Operations – Europe

CORPORATE HEADQUARTERS

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Web site: <http://www.viatel.com>

INVESTOR RELATIONS

Cindy B. Glynn
Director, Investor Relations
Phone: (212) 350-7492
(800) 952-4255
E-mail: investor@viatel.com

Stockholders can obtain a complete copy of the Company's Form 10-K Report for the year ended December 31, 1998 and other financial information, at no cost, by writing or telephoning investor relations at our general office address on this page.

TRANSFER AGENT

The Bank of New York
101 Barclay Street, 12W
New York, New York 10286

INDEPENDENT PUBLIC ACCOUNTANTS

KPMG LLP
345 Park Avenue
New York, New York 10154

GENERAL COUNSEL

Kelley Drye & Warren LLP
101 Park Avenue
New York, New York 10178

STOCK LISTING

Nasdaq National Market
Ticker Symbol: VYTL

ANNUAL MEETING OF STOCKHOLDERS

The Annual Meeting of Stockholders will be held at 10:00 A.M. on September 14, 1999 in the Whitney Room Hotel InterContinental 111 East 48th Street New York, New York 10017.

This document may contain forward-looking statements that involve risks and uncertainties. These statements may differ from actual future events or results. Readers are referred to the documents filed by Viatel with the SEC, specifically the most recent registration statements and reports which identify important risk factors that could cause actual results to differ from those contained in the forward-looking statements, including failure to complete construction of portions of our network on time and on budget, adverse changes in regulatory environment, potential fluctuations in quarterly results and our substantial leverage. Viatel undertakes no obligation to review or confirm analysts' expectations or estimates or to release publicly any revisions to any forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 1999

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission File Number: 000-21261

VIATEL, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

13-3787366

(I.R.S. Employer Identification No.)

685 Third Avenue

New York, New York

(Address of principal executive offices)

10017

(Zip Code)

(212) 350-9200

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ☒ Yes ☐ No

As of August 2, 1999, 32,596,944 shares of the registrant's Common Stock, \$.01 par value, were outstanding.

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

VIATEL, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(in thousands, except share data)

	June 30, 1999 (Unaudited)	December 31, 1998
Assets		
Current assets:		
Cash and cash equivalents	\$ 536,659	\$ 329,511
Restricted cash equivalents	11,987	10,310
Restricted marketable securities, current	90,308	50,870
Marketable securities, current	-	171,771
Trade accounts receivable, net of allowance for doubtful accounts of \$2,983 and \$3,093, respectively	44,520	28,517
Other receivables	28,354	13,404
Prepaid expenses	7,999	2,417
Total current assets	<u>719,827</u>	<u>606,800</u>
Restricted marketable securities, non-current	94,285	83,343
Property and equipment, net	587,903	266,256
Cash securing letters of credit for network construction	112,404	-
Intangible assets, net	68,349	46,968
Other assets	11,744	5,744
	<u>\$1,594,512</u>	<u>\$1,009,111</u>
Liabilities and Stockholders' Equity (Deficiency)		
Current liabilities:		
Accrued telecommunications costs	\$ 46,563	\$ 26,518
Accounts payable and other accrued expenses	21,910	23,656
Property and equipment purchases payable	202,282	97,288
Accrued interest	23,368	12,240
Liability under joint construction agreement	3,266	9,523
Current installments of notes payable and obligations under capital leases	11,101	8,918
Total current liabilities	<u>308,490</u>	<u>178,143</u>
Long-term liabilities:		
Long-term debt	1,240,487	896,503
Notes payable and obligations under capital leases, excluding current installments	32,929	24,636
Total long-term liabilities	<u>1,273,416</u>	<u>921,139</u>
Series A Redeemable Convertible Preferred Stock, \$.01 par value; Authorized 718,042 Shares; issued and outstanding none and 461,258 shares, respectively	-	47,121
Commitments and contingencies		
Stockholders' equity (deficiency):		
Preferred Stock, \$.01 par value. Authorized 1,281,958 shares, no shares issued and outstanding	-	-
Common Stock, \$.01 par value. Authorized 50,000,000 shares, issued and outstanding 32,586,190 and 23,184,465 shares, respectively	326	232
Additional paid-in capital	389,754	128,357
Unearned compensation	(6,442)	-
Accumulated other comprehensive loss	(27,461)	(6,246)
Accumulated deficit	(343,571)	(259,635)
Total stockholders' equity (deficiency)	<u>12,606</u>	<u>(137,292)</u>
	<u>\$1,594,512</u>	<u>\$1,009,111</u>

See accompanying notes to consolidated financial statements.

VIATEL, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Operations
(Unaudited)
(in thousands, except per share data)

	For the Three Months Ended June 30.		For the Six Months Ended June 30.	
	1999	1998	1999	1998
Revenue:				
Communication services revenue	\$ 47,849	\$ 27,751	\$ 96,243	\$ 48,990
Capacity sales	20,855	-	34,102	-
Total revenue	<u>68,704</u>	<u>27,751</u>	<u>130,345</u>	<u>48,990</u>
Operating expenses:				
Cost of services and sales	52,559	25,096	103,607	44,201
Selling, general and administrative	21,090	10,433	39,853	19,388
Depreciation and amortization	11,978	4,126	21,582	7,037
Total operating expenses	<u>85,627</u>	<u>39,655</u>	<u>165,042</u>	<u>70,626</u>
Other income (expense):				
Interest income	6,937	9,303	13,766	9,813
Interest expense	<u>(35,498)</u>	<u>(22,550)</u>	<u>(61,665)</u>	<u>(26,331)</u>
Loss before extraordinary loss	<u>(45,484)</u>	<u>(25,151)</u>	<u>(82,596)</u>	<u>(38,154)</u>
Extraordinary loss on debt prepayment	-	(28,304)	-	(28,304)
Net loss	<u>(45,484)</u>	<u>(53,455)</u>	<u>(82,596)</u>	<u>(66,458)</u>
Dividend on redeemable convertible preferred stock	(164)	(1,010)	(1,341)	(1,010)
Net loss attributable to common stockholders	<u>\$ (45,648)</u>	<u>\$ (54,465)</u>	<u>\$ (83,937)</u>	<u>\$ (67,468)</u>
Loss per common share, basic and diluted:				
Before extraordinary item	\$ (1.77)	\$ (1.13)	\$ (3.42)	\$ (1.71)
From extraordinary item	-	(1.23)	-	(1.23)
Net loss attributable to common stockholders	<u>\$ (1.77)</u>	<u>\$ (2.36)</u>	<u>\$ (3.42)</u>	<u>\$ (2.94)</u>
Weighted average common shares outstanding, basic and diluted	<u>25,846</u>	<u>23,095</u>	<u>24,524</u>	<u>22,940</u>

See accompanying notes to consolidated financial statements.

VIATEL, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(Unaudited)
(in thousands)

	For the Six Months Ended June 30,	
	1999	1998
Cash flows from operating activities:		
Net loss	\$ (82,596)	\$ (66,458)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	21,582	7,037
Accreted interest expense on long term debt	20,935	25,517
Provision for losses on accounts receivable	4,036	1,955
Extraordinary loss on debt prepayment	-	28,305
Earned compensation	108	33
Changes in assets and liabilities:		
Increase in accounts receivable and accrued interest	(16,588)	(14,730)
Increase in accrued interest expense on Senior Notes	11,129	-
(Increase) decrease in prepaid expenses and other receivables	(25,478)	3,502
Increase in other assets and intangible assets	(901)	(440)
Increase in accrued telecommunication costs, accounts payable and other accrued expenses	12,842	7,471
Net cash used in operating activities	(54,931)	(7,808)
Cash flows from investing activities:		
Purchase of property, equipment and software	(225,864)	(12,721)
Payment for business acquired, net of cash acquired	(12,000)	(5,000)
Purchase of marketable securities	(219,725)	(159,264)
Proceeds from maturity of marketable securities	299,049	30,085
Cash securing letters of credit	(112,404)	-
Issuance of notes receivable	(4,498)	-
Net cash used in investing activities	(275,442)	(146,900)
Cash flows from financing activities:		
Proceeds from issuance of senior notes and senior discount notes	365,471	834,703
Proceeds from issuance of convertible debentures and convertible preferred stock	-	53,246
Repayment of senior discount notes	-	(119,282)
Deferred financing costs	(12,880)	(31,547)
Proceeds from issuance of Common Stock	194,150	623
Repayment of notes payable and bank credit line	(1,615)	(2,033)
Payments under capital leases	(2,241)	(137)
Net cash provided by financing activities	542,885	735,573
Effects of exchange rate changes on cash	(3,688)	131
Net increase in cash and cash equivalents	208,824	580,996
Cash and cash equivalents at beginning of period	339,822	21,096
Cash and cash equivalents at end of period	\$ 548,646	\$ 602,092
Supplemental disclosures of cash flow information:		
Interest paid	\$ 28,651	\$ 673
Assets acquired under capital lease obligations	\$ 13,550	-
Conversion of preferred stock and convertible debentures	\$ 60,791	-

See accompanying notes to consolidated financial statements.

VIATEL, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Information as of June 30, 1999 and for the periods ended June 30, 1999 and 1998 is unaudited)

(1) Description of Business

Viatel Inc. and subsidiaries (collectively, the "Company") is a global integrated services provider of long distance communication and data services to end users, carriers and resellers. The Company operates a pan-European network with points of presence in 45 cities, direct sales forces in twelve Western European cities and an indirect sales force in more than 180 locations in Western Europe. The Company is currently constructing a series of interconnected state-of-the-art, high quality, high capacity, self-healing fiber optic rings utilizing the synchronous digital hierarchy standard for digital transmission which will connect major cities in six European countries (the "Circe Network").

(2) Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements as of June 30, 1999 and for the three and six month periods ended June 30, 1999 and 1998, respectively, have been prepared by the Company without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, all adjustments (consisting of only normal recurring adjustments) necessary for a fair presentation of the consolidated financial position, results of operations and cash flows for each period presented have been made on a consistent basis. Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations although management believes that the disclosures herein are adequate to make the information presented not misleading. It is suggested that these financial statements be read in conjunction with the Company's annual consolidated financial statements. Certain reclassifications have been made to the prior years' condensed consolidated financial statements to conform to the current year's presentation. Operating results for the three and six months ended June 30, 1999 may not be indicative of the results that may be expected for the full year.

Capacity Sales

Customers of the Company can purchase capacity on the Company's network. Revenues from the sale of network capacity are recognized in the period that the rights and obligations of ownership transfer to the purchaser.

Cost of capacity sales in any period is determined based upon the ratio of total capacity sold and total anticipated capacity to be utilized multiplied by the related total costs of the relevant portion of the Company's network.

New Pronouncements

On January 1, 1999, the Company adopted Statement of Position 98-5 (SOP 98-5), "Reporting on the Costs of Start-Up Activities," issued by the American Institute of Certified Public Accountants. SOP 98-5 requires that certain start-up expenditures and organization costs previously capitalized must now be expensed. The adoption of this statement did not have a material effect on our consolidated financial statements.

(3) Investments in debt securities

Management determines the appropriate classification of its investments in debt securities at the time of purchase and classifies them as held to maturity or available for sale. These investments are diversified among high credit quality securities in accordance with the Company's investment policy. Debt securities that the Company has both the intent and ability to hold to maturity are carried at amortized cost. Debt securities for which the Company does not have the intent or ability to hold to maturity are classified as available for sale. Securities available for sale are carried at fair value, with the unrealized gains and losses, net of tax, reported in a separate component of stockholders' equity. The Company does not invest in securities for the purpose of trading and therefore does not classify any securities as trading.

Debt securities classified as held to maturity are adjusted for amortization of premiums and accretion of discounts to maturity over the estimated life of the security. Such amortization and interest are included in interest income. There were no securities classified as available for sale as of June 30, 1999.

The following is a summary of the amortized cost, which approximates fair value, of restricted securities held to maturity at June 30, 1999 (in thousands) :

U.S. Treasury obligations	\$129,351
German corporate obligations	55,242
Total	<u>\$184,593</u>

The amortized cost, which approximates fair value, of restricted securities held to maturity at June 30, 1999 are shown below (in thousands) :

Due within one year	\$ 90,308
Due after one through two years	94,285
Total	<u>\$ 184,593</u>

There were no changes in the classification of any securities held to maturity or securities available for sale from the time of purchase to the time of maturity or sale.

(4) Property and Equipment

Property and equipment consists of the following as of (in thousands) :

	June 30, 1999	December 31, 1998
Communication system	\$ 385,621	\$ 96,193
Construction in progress	212,179	172,630
Furniture, equipment and other	20,106	16,450
Leasehold improvements	8,611	6,651
	<u>626,517</u>	<u>291,924</u>
Less accumulated depreciation and amortization	38,614	25,668
	<u>\$ 587,903</u>	<u>\$ 266,256</u>

At June 30, 1999, construction in progress primarily represents construction of the Circe Network. For the six month periods ended June 30, 1999 and 1998, \$4.6 million and \$0.9 million, respectively, of interest was capitalized.

In connection with the Company's joint construction of the civil works associated with a national communications network being constructed in Germany during 1999, the Company was required to obtain a letter of credit in support of its obligation. At June 30, 1999, the total amount outstanding relating to this letter of credit was approximately \$112.4 million (DM212.8 million).

(5) Intangible Assets

Intangible assets consist of the following as of (in thousands) :

	June 30, 1999	December 31, 1998
Deferred financing and registration fees	\$ 44,427	\$ 31,547
Licenses, trademarks, and servicemarks	9,347	10,031
Goodwill	20,270	8,744
Purchased software	3,524	1,859
Other	-	206
	<u>77,568</u>	<u>52,387</u>
Less accumulated amortization	<u>9,219</u>	<u>5,419</u>
	<u>\$ 68,349</u>	<u>\$ 46,968</u>

During the first half of 1999, the Company recognized and paid its obligation for contingent consideration for its 1998 acquisition of Flat Rate based upon key operating performance targets being met during the period ended March 31, 1999. Such contingent consideration has been recorded as goodwill.

(6) Long Term Debt and Convertible Securities

On March 19, 1999 the Company completed a high yield offering through which it raised \$365.5 million of gross proceeds (\$352.6 million of net proceeds).

At June 30, 1999, the Company has aggregate long term debt consisting of senior notes due 2008 and senior discount notes due 2009 which totals \$1.3 billion. A portion of the proceeds from the senior notes were used to purchase U.S. and German government securities which were pledged as security for the first six and four interest payments on the senior notes due 2008 and 2009, respectively. The amount of restricted securities remaining pledged as security for these notes is \$184.6 million. The senior discount notes accrete through April 15, 2003 and interest becomes payable in cash in semi-annual installments thereafter. The interest on the senior notes is payable in semi-annual installments. The indentures pursuant to which the senior notes and the senior discount notes were issued contain certain covenants that, among other things, limit the ability of the Company to incur additional indebtedness, pay dividends or make certain other distributions, enter into transactions with stockholders and affiliates and create liens on its assets. In addition, upon a change of control, the Company is required to make an offer to purchase the senior notes and the senior discount notes at a purchase price equal to 101% of the principal amount, in the case of the senior notes, and 101% of the accreted value of the notes, in the case of the senior discount notes.

Long term debt consists of the following as of (in thousands) :

	June 30, 1999	December 31, 1998
11.25% Senior Notes	\$ 400,000	\$ 400,000
11.15% Senior Notes (E91,010)	94,009	106,015
11.50% Senior Notes	200,000	-
11.50% Senior Notes (E150,000)	154,943	-
12.50% Senior Discount Notes, less discount of \$184,136	315,864	297,284
12.40% Senior Discount Notes, (E115,552), less discount of \$43,688 (E42,294)	75,671	80,355
10% Subordinated Convertible Debentures	-	12,849
	<u>\$ 1,240,487</u>	<u>\$ 896,503</u>

The Company's 10% Series A Preferred Stock and the Subordinated Convertible Debentures issued in connection with the Company's 1998 high yield offering were mandatorily convertible in the event the closing price of the Company's common stock exceeded certain predetermined annual price targets. On May 13, 1999, the conditions for mandatory conversion were met for both the Series A Preferred Stock and the Subordinated Convertible Debentures. The conversion rates for the Series A Preferred Stock and Subordinated Convertible Debentures were \$13.20 and DM24.473, at the then applicable exchange rates, respectively. Accordingly, the Company issued approximately 4.6 million shares of its common stock and paid cash for any fractional shares due upon conversion.

During 1997, the Company entered into Loan and Security Agreements pursuant to which the Company borrowed an aggregate of \$11.1 million. Under the terms of these agreements, the Company is required to satisfy certain covenants and restrictions. As of June 30, 1999, the Company was either in compliance with, or had received waivers to, these covenants. Obligations under these Loan and Security Agreements are secured by the grant of a security interest in certain telecommunications equipment as well as a portion of the payment obligations also being secured by letters of credit.

(7) Stock Incentive Plan

The Amended Stock Incentive Plan (the "Stock Incentive Plan") allows for the issuance of approximately 3.6 million shares of the Company's common stock, of which approximately 0.2 million shares are available for future grants as of June 30, 1999.

Stock option activity for the six months ended June 30, 1999 under the Stock Incentive Plan is shown below (in thousands) :

	Weighted Average Exercise Prices	Number of Shares
Outstanding at December 31, 1998	\$ 7.41	2,594
Granted	26.57	703
Exercised	6.01	(329)
Forfeited	5.85	(1)
Outstanding at June 30, 1999	<u>\$ 12.10</u>	<u>2,967</u>

As of June 30, 1999, approximately 1.4 million options were exercisable under the Stock Incentive Plan.

(8) Comprehensive Loss

The Company's comprehensive loss is as follows (in thousands) :

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	1999	1998	1999	1998
Net loss	<u>\$(45,484)</u>	<u>\$(53,455)</u>	<u>\$ (82,596)</u>	<u>\$(66,458)</u>
Foreign currency translation adjustment	(12,379)	652	(21,215)	135
Comprehensive loss	<u>\$(57,863)</u>	<u>\$(52,803)</u>	<u>\$(103,811)</u>	<u>\$(66,323)</u>

(9) Segment and Geographic Data

While the Company's chief decision maker monitors revenue streams of the various products and geographic locations, operations are managed and financial performance is evaluated based on the delivery of multiple, integrated services to customers over a single network. As a result, there are many shared expenses generated by the various revenue streams and management believes that any allocation of the expenses incurred to multiple revenue streams or geographic locations would be impractical and arbitrary. Management does not currently make such allocations internally.

The Company groups its products and services by wholesale, retail, and capacity. The information below summarizes revenue by customer type for the three and six months ended June 30, 1999 and 1998, respectively (in thousands):

	For the three months ended June 30,		For the six months ended June 30,	
	1999	1998	1999	1998
Retail.....	\$27,354	\$12,304	\$ 54,688	\$ 24,066
Wholesale.....	20,495	15,447	41,555	24,924
Capacity.....	20,855	-	34,102	-
Consolidated.....	<u>\$68,704</u>	<u>\$27,751</u>	<u>\$130,345</u>	<u>\$48,990</u>

The information below summarizes revenue by geographic area for the three months and the six months ended June 30, 1999 and 1998, respectively (in thousands):

	For the three months ended June 30,		For the six months ended June 30,	
	1999	1998	1999	1998
Western Europe.....	\$54,109	\$13,349	\$ 95,558	\$ 24,577
North America.....	12,272	10,178	29,524	15,885
Latin America.....	2,287	3,812	5,184	7,500
Asia/Pacific Rim and other.....	36	412	79	1,028
Consolidated.....	<u>\$68,704</u>	<u>\$27,751</u>	<u>\$130,345</u>	<u>\$ 48,990</u>

The information below summarizes long lived assets by geographic area as of June 30, 1999 and December 31, 1998, respectively (in thousands):

	June 30, 1999	December 31, 1998
Western Europe.....	\$ 544,703	\$ 237,443
North America.....	71,817	46,837
Latin America.....	205	289
Consolidated.....	<u>\$ 616,725</u>	<u>\$ 284,569</u>

(10) Equity Offering

On June 29, 1999, the Company completed an offering of 4,315,000 shares of its common stock at \$47 per share. The net proceeds of the offering were approximately \$192.2 million and will be used primarily to fund the further development of the network as well as for working capital and general corporate purposes.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

We are a rapidly growing international communications company providing high quality, competitively priced, long distance communication and data services to end users, carriers and resellers. We maintain direct sales forces in twelve Western European cities and an indirect sales force in more than 180 locations throughout Western Europe.

To capitalize on the opportunities presented by deregulation of the telecommunication industry in Western Europe, we established an early presence and acquired licenses, interconnection and infrastructure. Today, we hold licenses in Belgium, France, Germany, The Netherlands, Italy and the United Kingdom and interconnection agreements with each incumbent telecommunications operator in these countries. We also have licenses in Spain and Switzerland and expect to obtain interconnection in these countries.

We currently operate one of Europe's largest pan-European networks, with points of presence in 45 cities. We believe that control of network infrastructure is critical to becoming a high quality, low cost provider of communications services. We also believe that network ownership will enable us to better manage service offerings. Accordingly, we are in the process of migrating from a network comprised of international and domestic leased infrastructure to a network comprised primarily of owned infrastructure.

The Circe Network

The Company is currently constructing five interconnected, bi-directional, state-of-the-art, fiber optic rings, which, when completed will encompass approximately 8,700 route kilometers of fiber optic cable (the "Circe Network"). The first phase of the Circe Network, consisting of approximately 1,850 route kilometers was completed in March 1999 and connects, among other cities, London, Paris, Amiens, Brussels, Antwerp, Rotterdam, and Amsterdam. The second phase of the Circe Network became operational in July 1999 and now carries commercial traffic to London, Paris, Amiens, Nancy, Strasbourg, Dusseldorf, Frankfurt, Mannheim, Antwerp, Brussels, Rotterdam and Amsterdam. Construction on a third phase, which will connect Essen, Hamburg, Berlin, Dresden, Bremen, Leipzig, Nurnberg, Munich, Stuttgart, Frankfurt and Koln, has commenced and is expected to be available during the first quarter of 2000. We anticipate that the fourth and fifth phases of the Circe Network, which will extend into southern France and Switzerland, will be completed during the second quarter of 2000.

We began selling capacity on the Circe Network during the first quarter of 1999. Revenue from capacity sales that qualify under generally accepted accounting principles to be treated as sales are recognized under a line item titled "Capacity sales". Capacity sales are recognized as revenue when the purchaser obtains the right to use the capacity. The related cost of capacity is reported in the same period. With respect to each sale of capacity, the related cost of capacity sales is equal to a proportionate amount of the total capitalized cost of the related network. Revenue from operating leases of private line circuits will be included in communication services revenue and will be recognized on a straight line basis over the life of the lease. The portion of the total capitalized cost of the Circe Network used to provide communication services is included in property and equipment and is being charged to depreciation and amortization over its useful life. The sale of capacity on the Circe Network will vary substantially from period to period and, as a result, may result in fluctuations in our operating results.

We expect to trade capacity on the Circe Network for capacity on other cable systems. Depending on structure, these trades of capacity may be considered to be non-monetary exchanges and may have a material effect on our statement of operations. We will continue to incur sales and marketing and related expenses that will not be capitalized and will affect our results of operations, particularly while the Circe Network is being designed, built and placed into service. In addition, we will continue to incur additional operating and maintenance expense as the remaining Circe phases become operational. As a result of financing the Circe Network with debt, we are capitalizing a portion of the interest incurred that relates to the construction of the Circe Network until it is placed in service and will incur substantial increases in interest expense thereafter.

The Circe Network will have a beneficial effect on our costs of services and sales as well as net income (loss). This will occur as we bring traffic "on-net," to facilities we own, as opposed to facilities that we lease from other carriers. A large portion of the expenses associated with facilities we own is accounted for as depreciation and amortization, while leased capacity is accounted for as a cost of services and sales. As a result, we expect that our gross margins and profit will be improved as we bring traffic "on-net". However, our net income (loss) will not improve to the same extent. The effect of bringing traffic "on-net" will be somewhat delayed, because our leased line agreements require minimum notification to terminate our obligations.

Results of Operations

The following table summarizes the breakdown of our results of operations as a percentage of revenue. Our revenue, and therefore these percentages, could fluctuate substantially from period to period due to capacity sales, which have a substantially different impact on margins than communications services.

	Three months ended June 30,		Six months ended June 30,	
	1999	1998	1999	1998
Revenue	100.0%	100.0%	100.0%	100.0%
Cost of services and sales	76.5%	90.4%	79.5%	90.2%
Selling, general and administrative expenses	30.7%	37.6%	30.6%	39.6%
Depreciation and amortization	17.4%	14.9%	16.6%	14.4%
EBITDA loss (1)	7.2%	28.0%	10.1%	29.8%

(1) As used herein "EBITDA" consists of earnings before interest, income taxes, extraordinary loss, dividends on convertible preferred stock and depreciation and amortization. EBITDA is a measure commonly used in the telecommunications industry to analyze companies on the basis of operating performance. EBITDA is not a measure of financial performance under generally accepted accounting principles, is not necessarily comparable to similarly titled measures of other companies and should not be considered as an alternative to net income as a measure of performance nor as an alternative to cash flow as a measure of liquidity.

Three Months Ended June 30, 1999 compared to the Three Months Ended June 30, 1998

Revenue. Revenue is derived from communication service and capacity sales. Revenue increased by 147.1% to \$68.7 million for the three months ended June 30, 1999 from \$27.8 million for the three months ended June 30, 1998. This growth was attributable to a 71.9% increase in communication services revenue which increased to \$47.8 million on 278.5 million billable minutes for the second quarter of 1999 from \$27.8 million on 83.3 million billable minutes for the second quarter of 1998. Capacity sales were \$20.9 million for the second quarter of 1999. We had no capacity sales during the second quarter of 1998. Revenue growth for the second quarter of 1999 continues to be generated primarily by growth from European revenues and capacity sales.

Although there was a substantial increase in billable minutes from the second quarter of 1998 to the second quarter of 1999, the effects of such growth were partially offset by a decline in revenue per billable minute, as revenue per billable minute declined by 48.5% to \$.17 in the second quarter of 1999 from \$.33 in the second quarter of 1998, primarily because of (i) a higher percentage of lower-priced intra-European and national long distance traffic on our network and (ii) reductions in prices in response to price reductions by incumbent telecommunications operators and other carriers in many of our markets.

Communication services revenue per billable minute from the sale of services to retail customers, which represented 39.8% of revenue for the three months ended June 30, 1999 compared to 44.3% for the three months ended June 30, 1998, decreased 69.6% to \$.14 in the second quarter of 1999 from \$.46 in the second quarter of

1998. Communication services revenue per billable minute from the sale of services to carriers and other resellers decreased 7.4% to \$.25 in the second quarter of 1999 from \$.27 in the second quarter of 1998.

During the second quarter of 1999 as compared to the second quarter of 1998, our carrier business (through which we provide switched minutes, private lines and ports to carriers, Internet Service Providers and other resellers) decreased as a percentage of revenue, but grew on an absolute basis because our other services grew at a faster rate. The carrier business represented approximately 29.8% of total revenue and approximately 29.8% of billable minutes for the three months ended June 30, 1999 as compared to approximately 55.7% of total revenue and approximately 67.8% of billable minutes for the three months ended June 30, 1998.

Cost of Services and Sales. Cost of services and sales increased to \$52.6 million in the second quarter of 1999 from \$25.1 million in the second quarter of 1998. As a percentage of revenue, however, cost of services and sales decreased to approximately 76.5% for the three months ended June 30, 1999 from approximately 90.4% for the three months ended June 30, 1998. Cost of services and sales for the three months ended June 30, 1999 includes costs associated with the sale of capacity on the network. The cost of the sold capacity represented non-cash charges of the pro rata cost of the network asset and is determined based upon the ratio of total capacity sold to total estimated capacity multiplied by the total capitalized costs of the related network.

Cost of services and sales continued to increase in the three months ended June 30, 1999 in part because of the relatively high cost of leased infrastructure associated with the increase in minutes. These costs are expected to decrease as a percentage of revenue as we migrate from leased infrastructure to the Circe Network and other owned capacity. The effect of bringing traffic "on-net" will be somewhat delayed because our leased line agreements require minimum notification to terminate our obligations.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased to \$21.1 million in the three months ended June 30, 1999 from \$10.4 million in the three months ended June 30, 1998 and, as a percentage of revenue, decreased to approximately 30.7% in the three months ended June 30, 1999 from approximately 37.6% in the same period in 1998. Much of these expenses are attributable to overhead costs associated with our headquarters, back office and operations as well as maintaining a physical presence in multiple jurisdictions. We expect to incur additional expenses as we continue to invest in operating infrastructure and actively market our products and services. Salaries and commissions, as a percentage of total selling, general and administrative expenses, were approximately 43.1% and 47.8% for the three months ended June 30, 1999 and 1998, respectively. Advertising and promotion expenses, as a percentage of total selling, general and administrative expenses, were approximately 4.1% and 3.3% for the three months ended June 30, 1999 and 1998, respectively.

EBITDA Loss. EBITDA loss decreased to \$4.9 million for the three months ended June 30, 1999 from \$7.8 million for the three months ended June 30, 1998. As a percentage of revenue, EBITDA loss decreased to approximately 7.2% in the second quarter of 1999 from approximately 28.0% in the same quarter of 1998. We expect this trend to continue as we migrate traffic from leased lines to our own network.

Depreciation and Amortization. Depreciation and amortization expense, which includes depreciation of the network, increased to approximately \$12.0 million in the quarter ended June 30, 1999 from approximately \$4.1 million in the quarter ended June 30, 1998. The increase was due primarily to the \$516.0 million increase in gross property and equipment from \$110.5 million at June 30, 1998 to \$626.5 million at June 30, 1999. Depreciation expense will increase substantially as each additional ring of the Circe Network becomes operational.

Interest. Interest expense increased from approximately \$22.6 million in the three months ended June 30, 1998 to approximately \$35.5 million in the three months ended June 30, 1999, primarily as a result of increases in outstanding indebtedness, which includes notes and capital lease obligations, which increased from \$870.4 million at June 30, 1998 to \$1.3 billion at June 30, 1999. During the three months ended June 30, 1999, we capitalized \$2.3 million of interest costs. Interest income decreased from approximately \$9.3 million during the three months ended June 30, 1998 to approximately \$6.9 million in the three months ended June 30, 1999, primarily as a result of our investment in capital expenditures relating to the development of the Circe Network.

Six Months Ended June 30, 1999 Compared to the Six Months Ended June 30, 1998

Revenue. Revenue increased by 165.9% to \$130.3 million for the six months ended June 30, 1999 from \$49.0 million for the six months ended June 30, 1998. This growth was attributable to a 96.3% increase in communication services revenue to \$96.2 million on 549.3 million billable minutes for the first half of 1999 from \$49.0 million on 135.7 million billable minutes for the first half of 1998. Capacity sales represented \$34.1 million for the first half of 1999. We had no capacity sales during the first half of 1998. Revenue growth for the first six months of 1999 continues to be generated primarily by growth from European revenues and capacity sales.

Although there was a substantial increase in billable minutes from the first six months of 1998 to the first six months of 1999, the effects of such growth were partially offset by a decline in revenue per billable minute, as revenue per billable minute declined by 64.9% to \$.13 in the first half of 1999 from \$.36 in the first half of 1998, primarily because of (i) a higher percentage of lower-priced intra-European and national long distance traffic on our network and (ii) reductions in prices in response to price reductions by incumbent telecommunications operators and other carriers in many of our markets.

Communication services revenue per billable minute from the sale of services to retail customers, which represented 42.0% of revenue for the six months ended June 30, 1999 compared to 48.9% for the six months ended June 30, 1998, decreased 70.8% to \$.14 in the first half of 1999 from \$.48 in the first half of 1998. Communication services revenue per billable minute from the sale of services to carriers and other resellers decreased to \$.27 in the first six months of 1999 from \$.28 in the first six months of 1998.

During the first half of 1999 as compared to the first half of 1998, our carrier business has declined as a percentage of communications service revenue, but has grown on an absolute basis because our retail services grew at a faster rate. The carrier business represented approximately 31.9% of revenue and approximately 28.5% of billable minutes for the six months ended June 30, 1999 as compared to approximately 49.6% of revenue and approximately 63.3% of billable minutes for the six months ended June 30, 1998.

Cost of Services and Sales. Cost of services and sales increased to \$103.6 million in the first half of 1999 from \$44.2 million in the first half of 1998. As a percentage of revenue, however, cost of services and sales decreased to approximately 79.5% for the six months ended June 30, 1999 from approximately 90.2% for the six months ended June 30, 1998. Cost of services and sales for the six months ended June 30, 1999 includes costs associated with the sale of capacity on the network. The cost of the sold capacity represented non-cash charges of the pro rata cost of the network asset and is determined based upon the ratio of total capacity sold to total estimated capacity multiplied by the total capitalized costs of the related network.

Cost of services and sales continued to increase in the six months ended June 30, 1999 in part because of the relatively high cost of leased infrastructure associated with the increase in minutes. These costs are expected to decrease as a percentage of revenue as we migrate from leased infrastructure to the Circe Network and other owned capacity. The effect of bringing traffic "on-net" will be somewhat delayed because our leased line agreements require minimum notification to terminate our obligations.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased to \$39.9 million for the six months ended June 30, 1999 from \$19.4 million for the six months ended June 30, 1998 and, as a percentage of revenue, decreased to approximately 30.6% for the six months ended June 30, 1999 from approximately 39.6% for the corresponding period in 1998. Much of these expenses are attributable to overhead costs associated with our headquarters, back office and operations as well as maintaining a physical presence in multiple jurisdictions. We expect to incur additional expenses as we continue to invest in operating infrastructure and actively market our products and services. Salaries and commissions, as a percentage of total selling, general and administrative expenses, were approximately 45.2% and 49.9% for the six months ended June 30, 1999 and 1998, respectively. Advertising and promotion expenses, as a percentage of total selling, general and administrative expenses, were approximately 4.6% and 2.3% for the six months ended June 30, 1999 and 1998, respectively.

EBITDA Loss. EBITDA loss decreased to \$13.1 million for the six months ended June 30, 1999 from \$14.6 million for the six months ended June 30, 1998. As a percentage of revenue, EBITDA loss decreased to approximately 10.1% in the first half of 1999 from approximately 29.8% in the first half of 1998.

Depreciation and Amortization. Depreciation and amortization expense, which includes depreciation of the network, increased to approximately \$21.6 million for the six months ended June 30, 1999 from approximately \$7.0 million for the six months ended June 30, 1998. The increase was due primarily to the \$516.0 million increase in gross property and equipment from \$110.5 million at June 30, 1998 to \$626.5 million at June 30, 1999.

Interest. Interest expense increased from approximately \$26.3 million in the six months ended June 30, 1998 to approximately \$61.7 million in the six months ended June 30, 1999, primarily as a result of increases in our outstanding indebtedness, which includes notes and capital lease obligations, which increased from \$870.4 million at June 30, 1998 to \$1.3 billion at June 30, 1999. During the six months ended June 30, 1999, we capitalized approximately \$4.6 million of interest costs. Interest income increased from approximately \$9.8 million in the six months ended June 30, 1998 to approximately \$13.8 million in the six months ended June 30, 1999 primarily as a result of the interim investment of the net proceeds from our debt and equity financings.

Liquidity and Capital Resources

We have incurred losses from operating activities in each year of operations since our inception and expect to continue to incur operating and net losses for the next several years. Since inception, we have utilized cash provided by financing activities to fund operating losses, interest expense and capital expenditures. The sources of this cash have primarily been through private and public equity and debt financings and, to a lesser extent, equipment-based financing. As of June 30, 1999, we had \$649.1 million of cash, cash equivalents, cash securing letters of credit for network construction and marketable securities and \$196.6 million of restricted cash equivalents and other restricted marketable securities, which primarily secure interest payments on our notes through April 2001.

On June 29, 1999, the Company completed an offering of 4,315,000 shares of its common stock at \$47 per share. The net proceeds of the offering were approximately \$192.2 million and will be used primarily to fund the further development of our network as well as for working capital and general corporate purposes.

On May 13, 1999, our Series A Preferred Stock and Subordinated Convertible Debentures converted into shares of our common stock. The conversion was based upon maintenance of our common stock above a certain per share price for a specified time period. The Series A Preferred Stock and the Subordinated Convertible Debentures converted at a conversion price equal to \$13.20 and DM24.473, at the then applicable exchange rate, respectively. Accordingly, we issued approximately 4.6 million shares of our Common Stock and paid cash for any fractional shares due upon conversion. These transactions, and their extinguishment of our related commitments, significantly strengthen the Company's financial position.

On March 19, 1999, we completed a high yield offering through which we raised approximately \$352.6 million of net proceeds in a combination of senior dollar notes and senior Euro notes.

On April 8, 1998, we completed a high yield offering through which we raised approximately \$856.6 million of net proceeds. A portion of the proceeds from this high yield offering were utilized by us to retire our 15% senior discount notes due 2005 pursuant to a tender offer.

The proceeds of the 1999 and 1998 high yield offerings are being used to construct the Circe Network. The Circe Network, when completed, will be one of the largest cross-border fiber optic networks in the largest telecommunications market in Western Europe. This five-ring system is expected to encompass approximately 8,700 route kilometers.

We believe that the net proceeds from the offerings, discussed above, together with cash and marketable securities on hand and future sales of the capacity on the Circe Network, will provide sufficient funds for us to expand our business as planned and to fund operating losses for at least the next 12 to 18 months. However, the amount of future capital requirements will depend on a number of factors, including the success of our business, the

start-up dates of each ring of the Circe Network, the dates at which we further expand our network, the types of services we offer, staffing levels, acquisitions and customer growth, as well as other factors that are not within our control, including competitive conditions, government regulatory developments and capital costs. In the event our plan or assumptions change or prove to be inaccurate, we are unable to convert from leased to owned infrastructure or obtain interconnection in accordance with our current plans or the net proceeds of our offerings, cash and investments on hand, equity offerings and the proceeds from the sale of capacity on the Circe Network prove to be insufficient to fund our growth in the manner and at the rate currently anticipated, we may be required to delay or abandon some or all of our development and expansion plans or we may be required to seek additional sources of financing earlier than currently anticipated. In the event we are required to seek additional financing, there can be no assurance that such financing will be available on acceptable terms at all.

Capital Additions; Commitments. The development of our business has required substantial capital. Capital additions consist of capital expenditures, the net increase in property and equipment purchases payable, assets acquired under capital lease obligations and capitalized interest during the period. For the six months ended June 30, 1999, we had capital additions of approximately \$349.1 million, which consisted of capital expenditures of approximately \$225.9 million, a net increase of \$105.0 million in property and equipment payable, \$13.6 million of assets acquired under capital lease obligations and capitalized interest of approximately \$4.6 million. We have also entered into certain agreements associated with the Circe Network, purchase commitments for network expansion and other items aggregating in excess of \$288.6 million at June 30, 1999. Additionally, we have minimum volume commitments to purchase transmission capacity from various domestic and foreign carriers aggregating approximately \$13.2 million for all of 1999.

Foreign Currency. We have exposure to fluctuations in foreign currencies relative to the U.S. Dollar as a result of billing portions of our communications services revenue in the local European currency in countries where the local currency is relatively stable while many of our obligations, including a substantial portion of our transmission costs, are denominated in U.S. Dollars. In countries with less stable currencies, such as Brazil, we bill in U.S. Dollars. Debt service on certain of the notes issued by us are currently payable in Euros. A substantial portion of capital expenditures are and will continue to be denominated in various European currencies, including the Euro. Most of the European currencies in which we do business converged effective January 1, 1999, with the exception of the British Pound Sterling.

With the continued expansion of our network, a substantial portion of the costs associated with the network, such as local access and termination charges and a portion of the leased line costs, as well as a majority of local selling expenses and debt service related to the Euro denominated notes, will be charged to us in the same currencies as revenue is billed. These developments create a natural hedge against a portion of our foreign exchange exposure. To date, much of the funding necessary to establish the local direct sales organizations has been derived from communications services revenue that was billed in local currencies. Consequently, our financial position as of June 30, 1999 and our results of operations for the six months ended June 30, 1999 were not significantly impacted by fluctuations in the U.S. Dollar in relationship to foreign currencies.

Year 2000

The Year 2000 problem is the result of computer programs, microprocessors and embedded date reliant systems using two digits rather than four to define the applicable year. If these programs are not corrected, such date sensitive computer programs, microprocessors and embedded systems may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in a system failure or miscalculation causing disruptions in operations.

In an effort to assess our Year 2000 state of readiness, during 1997 we began performing a complete inventory assessment of all of our internal systems, which we have divided into two categories, business essential, or mission critical, and support systems, or non-mission critical. As part of our Year 2000 program and as part of our overall procurement plan, we have sought to ensure that fixed assets acquired were Year 2000 compliant. At December 31, 1997, gross property and equipment was \$67.0 million compared to \$626.5 million at June 30, 1999, an increase of 835.1 percent. As part of this process, we have inventoried, tested, and ensured Year 2000 compliance of our mission critical systems. The inventory and testing of these mission critical systems is complete. The backbone of

our communications network is primarily composed of Nortel switches which are Year 2000 compliant. Our message processing and billing systems, which are used to record and process millions of call detail records, and our transmission equipment, which are our only mission critical systems, are also Year 2000 compliant. The majority of our non-mission critical systems are Year 2000 compliant. We anticipate our non-mission critical systems being Year 2000 compliant during the third quarter of 1999. The total estimated cost of ensuring our preparation for Year 2000 is approximately \$200,000, a portion of which has already been incurred and expensed.

We continue to communicate formally with the key carriers and other vendors on which our operations and infrastructure are dependent to determine the extent to which we are susceptible to a failure resulting from such third parties' inability to remediate their own Year 2000 problems. Accordingly, during the procurement process, we have taken steps to ensure that our vendors, carriers, and products purchased are Year 2000 compliant or are adequately addressing the Year 2000 issues. We can provide no assurance that the carriers and other vendors on which our operations and infrastructure rely are or will be Year 2000 compliant in a timely manner. Interruptions in the services provided to us by these third parties could result in disruptions in our services. Depending upon the extent and duration of any such disruptions and the specific services affected, such disruptions could have a material adverse affect on our business, financial condition and results of operations. As a contingency against any possible disruptions in services provided by vendors, we have sought to diversify our vendor base. We believe that the diversity of our vendor base is sufficient to mitigate Year 2000 related disruptions in service to customers. In addition, we believe that the fact we conduct business in, and derive revenue from, multiple Western European countries helps to mitigate the potential impact of Year 2000 related disruptions

In addition, disruptions in the economy generally resulting from the Year 2000 issue could also have a material adverse affect on us. We could be subject to litigation resulting from any disruption in our services. The amount of potential liability or lost revenue which would result from these disruptions in service could have a material adverse effect on our business, financial condition and results of operations.

Euro

On January 1, 1999, eleven of the fifteen member countries of the European Union established irrevocable fixed conversion rates between their existing sovereign currencies and a single currency called the Euro. The sovereign currencies are scheduled to remain legal tender as denominations of the Euro during a transition period from January 1, 1999 to January 1, 2002.

We have completed an internal analysis regarding business and systems issues related to the Euro conversion and, as a result, made necessary modifications to our business processes and software applications. We are now able to conduct business in both Euro and sovereign currencies on a parallel basis, as required by the European Union.

We believe that the Euro conversion has not and will not have a significant impact on our business strategy in Europe. The costs to convert all systems to be Euro compliant did not have a significant impact on our results of operations.

Inflation

We do not believe that inflation has had a significant effect on our operations to date.

Prospective Accounting Pronouncements

SFAS No. 133

Statement of Financial Accounting Standards No. 133 ("SFAS 133"), "Accounting for Derivative Instruments and Hedging Activities," was issued in June 1998. SFAS 133 standardizes the accounting for derivative instruments, including certain derivative instruments embedded in other contracts, by requiring recognition of those instruments as assets and liabilities and to measure them at fair value. We have not completed our analysis of the impact of this statement on our financial statements.

SFAS No. 137

In June 1999, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 137, "Accounting for Derivative Instruments and Hedging Activities – Deferral of the Effective Date of SFAS No. 133", which amends SFAS No. 133 to delay the date by which all companies must comply with SFAS 133. Companies must comply with SFAS No. 133 for all fiscal years beginning after June 15, 2000.

FASB Interpretation No. 43

FASB Interpretation No. 43, "Real Estate Sales – an interpretation of FASB Statement No. 66", was issued in June 1999. It clarifies the standards for recognition of profit on all real estate sales transactions including sales of real estate with property improvements or integral equipment that cannot be removed and used separately from the real estate without incurring significant costs. This interpretation is effective for all applicable real estate sales occurring after June 30, 1999. We have not completed our analysis of the impact of this statement on our financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

We are subject to foreign currency exchange rate risk relating to receipts from customers, payments to suppliers and interest and principal payments on the outstanding Euro denominated senior notes and senior discount notes in foreign currencies. We do not consider the market risk exposure relating to foreign currency exchange to be material. See "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - Foreign Currency."

We have financial instruments which are subject to interest rate risk, principally short-term investments and debt obligations issued at a fixed rate. Historically, we have not experienced material gains or losses due to interest rate changes when selling short-term investments and typically holding these securities until maturity. Based on current holdings of short-term investments, our exposure to interest rate risk is not material. Fixed-rate debt obligations issued by us are generally not callable until maturity.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

None.

Item 2. Changes in Securities and Use of Proceeds.

Not Applicable.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

Item 5. Other Information.

None.

Item 6. Exhibits and Reports on Form 8-K.

(A) *Exhibits.*

27 Financial Data Schedule

(B) *Reports on Form 8-K.*

No current reports on Form 8-K were filed by the Company during the quarter ended June 30, 1999.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

VIATEL, INC.

By: /s/ Michael J. Mahoney
Michael J. Mahoney
President and Chief Executive Officer

By: /s/ Allan L. Shaw
Allan L. Shaw
Senior Vice President, Finance and
Chief Financial Officer

Date: August 16, 1999

VIATEL, INC. SENIOR MANAGEMENT

Michael J. Mahoney. Mr. Mahoney has served as Chairman of the Board of Viatel since September 1998, as its Chief Executive Officer since 1997, as its President since September 1996 and as a director since 1995. Mr. Mahoney was also Chief Operating Officer of Viatel from September 1996 to September 1997, Executive Vice President, Operations and Technology of Viatel from July 1994 to September 1996 and Managing Director, Intercontinental of Viatel from January 1996 to September 1996. From August 1990 to June 1994, Mr. Mahoney was employed by SITEL Corporation, a teleservices company, most recently as President, Information Services Group. From August 1987 to August 1990, Mr. Mahoney was employed by URIX Corporation, a manufacturer of telecommunications hardware and software, in a variety of sales and marketing positions.

Allan L. Shaw. Mr. Shaw has served as Senior Vice President, Finance of Viatel since December 1997 and as its Chief Financial Officer since January 1996. Mr. Shaw has served as a director of Viatel since June 1996. Mr. Shaw was Vice President, Finance of Viatel from January 1996 to December 1997 and Treasurer of Viatel from September 1996 to April 1998. Prior to becoming Vice President, Finance and Chief Financial Officer, Mr. Shaw served as Corporate Controller from November 1994 to December 1995. From August 1987 to November 1994, Mr. Shaw was employed by Deloitte & Touche LLP, most recently as a Manager. Mr. Shaw is a Certified Public Accountant and a member of the American Institute, United Kingdom Society and New York State Society of Certified Public Accountants.

Lawrence G. Malone. Mr. Malone has served as Senior Vice President, Global Sales and Marketing of Viatel since May 1997. Mr. Malone served as Vice President and Managing Director, Intercontinental of Viatel from September 1996 to May 1997 and served as its Vice President of Sales for Carriers/Wholesale from January 1995 to September 1996. From December 1993 to December 1994, Mr. Malone was employed by Frame Relay Technologies, a communications equipment manufacturer, as Director of Sales. From December 1987 to November 1993, Mr. Malone was employed by Republic Telecom Systems a voice/data networking company, where he most recently served as Vice President of Sales and Marketing.

Sheldon M. Goldman. Mr. Goldman has served as Senior Vice President, Business and Legal Affairs of Viatel since August 1999. Prior to becoming Senior Vice President, Business and Legal Affairs of Viatel, Mr. Goldman served as Senior Vice President, Business Affairs and General Counsel from December 1997 to August 1999, Vice President, Business and Legal Affairs from December 1996 to December 1997 and United States General Counsel of Viatel from April 1996 to December 1996. From January 1987 to March 1996, Mr. Goldman was associated with the law firm of Wien, Malkin, & Bettex. Since March 1996, Mr. Goldman has been Of Counsel to the law firm of Brief Kesselman Knapp & Schulman, LLP.

Francis J. Mount. Mr. Mount has served as Senior Vice President, Engineering and Network Operations of Viatel since December 1997 and as a Director of the Company since June 1998. Prior to joining the company, Mr. Mount was Senior Vice President, Business Initiatives of Primus Telecommunications Group from October 1997 to December 1997, responsible for

Internet telephony, European operations and network quality. From June 1996 to October 1997, Mr. Mount was Executive Vice President and Chief Operating Officer of Telepassport, Inc. and was Vice President and Chief Operating Officer of Telepassport, Inc. from January 1996 to June 1997. From 1990 to January 1996, Mr. Mount was employed by MCI, most recently as Director, Global Technical Services, responsible for international development, alliance management and all technical operations and services outside the United States, including the construction and maintenance of large networks such as Hyperstream, "Concert" and private networks for large accounts such as J.P. Morgan, Proctor and Gamble and I.B.M. From March 1967 to December 1989, Mr. Mount was employed by AT&T in various positions.

AGREEMENT AND PLAN OF MERGER

AMONG

DESTIA COMMUNICATIONS, INC.,

VIATEL ACQUISITION CORP.

AND

VIATEL, INC.

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AGREEMENT AND PLAN OF MERGER

AGREEMENT AND PLAN OF MERGER (the "Agreement") dated as of August 27, 1999, by and among VIATEL, INC., a Delaware corporation ("Parent"). VIATEL ACQUISITION CORP., a Delaware corporation and a direct wholly-owned Subsidiary of Parent (the "Parent Subsidiary"), and DESTIA COMMUNICATIONS, INC., a Delaware corporation (the "Company"). Parent, the Parent Subsidiary and the Company are referred to collectively herein as the "Parties."

WITNESSETH:

WHEREAS, this Agreement contemplates a transaction in which Parent will acquire all of the outstanding capital stock of the Company through a merger of the Parent Subsidiary with and into the Company;

WHEREAS, the Board of Directors of each of Parent, the Parent Subsidiary and the Company has approved the acquisition of the Company by Parent, including the merger of the Parent Subsidiary with and into the Company (the "Merger"), upon the terms and subject to the conditions set forth herein;

WHEREAS, the Board of Directors of the Company has determined that the Merger is advisable and is fair to and in the best interests of the holders of the Company's voting common stock, par value \$.01 per share (the "Voting Shares"), and the holders of the Company's non-voting common stock, par value \$.01 per share (the "Nonvoting Shares"), and together with the Voting Shares (the "Company Shares"), and has resolved to recommend the approval of the Merger and the adoption of this Agreement by the Company Stockholders (as defined in §1 below);

WHEREAS, the Board of Directors of Parent has determined that the Merger is advisable and is fair to and in the best interests of the holders of Parent's common stock, par value \$0.01 per share (the "Parent Shares");

WHEREAS, the Parent Shares are listed for trading on the Nasdaq National Market ("Nasdaq") and the Board of Directors of the Parent has resolved to recommend the approval of the issuance of Parent Shares in connection with the Merger as provided in this Agreement by the Parent Stockholders (as defined in §1 below) as required by the rules of Nasdaq and, if necessary, approval of an amendment to the certificate of incorporation of Parent by the Parent Stockholders to increase the authorized number of Parent Shares;

WHEREAS, to induce Parent and the Parent Subsidiary to enter into this Agreement, Parent, the Parent Subsidiary and the Company have entered into a Stockholder Agreement (each a "Stockholder Agreement") with each of Alfred West, Steven West, Gary Bondi and PG Investors, L.P. (collectively, the "Stockholders," and individually, a "Stockholder");

WHEREAS, this Agreement contemplates that for U.S. Federal income tax purposes the Merger will qualify as a reorganization within the meaning of Code §368(a);

NOW, THEREFORE, in consideration of the premises and the mutual promises set forth herein, and in consideration of the representations, warranties and covenants set forth herein, the Parties agree as follows:

1. Definitions.

“Acquisition Proposal” means any proposal or offer (including, without limitation, any proposal or offer to the Company Stockholders) with respect to a merger, acquisition, consolidation, recapitalization, reorganization, liquidation, tender offer or exchange offer or similar transaction involving, or any purchase of 25% or more of the consolidated assets of, or any equity interest representing 25% or more of the outstanding shares of capital stock in, the Company.

“Affiliate” has the meaning set forth in Rule 12b-2 of the regulations promulgated under the Securities Exchange Act.

“Agreement” has the meaning set forth in the preambles.

“Blue Sky Filings” has the meaning set forth in §5(c)(i) below.

“Certificate of Merger” has the meaning set forth in §2(c) below.

“Circe Network” means Parent’s fiber-optic broadband networks completed or being constructed, in Western Europe.

“Circe Rights” means the authority, approvals, consents, franchises, rights of way, way leaves, easements, permits, licenses and/or other rights (contractual, governmental or otherwise) necessary for the construction and operation of the Circe Network.

“Closing” has the meaning set forth in §2(b) below.

“Closing Date” has the meaning set forth in §2(b) below.

“Closing Sales Price per Parent Share” means, on any day, the average of the last reported sale price of one Parent Share on the Nasdaq Stock Market for each of the five trading days immediately preceding such day.

“Code” has the meaning set forth in §3(o)(ii) below.

“Company” has the meaning set forth in the preambles.

“Company 10-K” has the meaning set forth in §3(h) below.

“Company 10-Q” has the meaning set forth in §3(h) below.

“Company Benefit Plan” and “Company Benefit Plans” have the meanings set forth in §3(o)(i) below.

“Company Board” means the board of directors of the Company.

“Company Contracts” has the meaning set forth in §3(u) below.

“Company Disclosure Letter” has the meaning set forth in §3(a) below.

“Company Employees” has the meaning set forth in §3(o)(i) below.

“Company ERISA Affiliate” has the meaning set forth in §3(o)(iii) below.

“Company Fairness Opinion” means an opinion of Morgan Stanley & Co. Incorporated, addressed to the Company Board, as to the fairness of the Per Share Merger Consideration to the Company Stockholders (other than Parent and the Parent Subsidiary) from a financial point of view.

“Company Intellectual Property” has the meaning set forth in §3(s) below.

“Company Material Adverse Effect” has the meaning set forth in §3(a) below.

“Company Pension Plan” has the meaning set forth in §3(o)(ii) below.

“Company Reports” has the meaning set forth in §3(g) below.

“Company Shares” has the meaning set forth in the preambles.

“Company Special Meeting” has the meaning set forth in §5(c)(ii) below.

“Company Stockholder” means any Person who or which holds any Company Shares.

“Confidentiality Agreement” means the letter agreement dated August 4, 1999 between Parent and the Company, providing that, among other things, each Party would maintain confidential certain information of the other Party.

“Confidential Information” means Information, as defined in the Confidentiality Agreement.

“Delaware General Corporation Law” means Title 8, Chapter 1 of the Delaware Code, as amended.

“Dissenting Shares” has the meaning set forth in §2(g) below.

“Effective Time” has the meaning set forth in §2(d)(i) below.

“Environmental Law” has the meaning set forth in §3(r) below.

“ERISA” has the meaning set forth in §3(o)(i) below.

“Exchange Agent” has the meaning set forth in §2(e)(i) below.

“Exchange Fund” has the meaning set forth in §2(e)(i) below.

“Foreign Competition Laws” means foreign statutes, rules, regulations, orders, decrees and administrative and judicial directives that are designed or intended to prohibit, restrict or regulate actions having the purpose or effect of monopolization, lessening of competition or restraint of trade.

“GAAP” means United States generally accepted accounting principles as in effect from time to time.

“Government Entity” has the meaning set forth in §3(f) below.

“Hart-Scott-Rodino Act” means the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended.

“Hazardous Substance” has the meaning set forth in §3(r) below.

“Indemnified Party” has the meaning set forth in §5(j)(ii) below.

“Joint Proxy Statement/Prospectus” has the meaning set forth in §5(c)(i) below.

“Merger” has the meaning set forth in the preambles.

“Merger Consideration” has the meaning set forth in §5(d)(v) below.

“Nasdaq” has the meaning set forth in the preambles.

“Nonvoting Shares” has the meaning set forth in the preambles.

“Order” has the meaning set forth in §6(a)(v) below.

“Outside Date” has the meaning set forth in §7(a)(ii) below.

“Parent” has the meaning set forth in the preambles.

“Parent 10-K” has the meaning set forth in §4(h) below.

“Parent 10-Q” has the meaning set forth in §4(h) below.

“Parent Acquisition Proposal” means any proposal or offer (including, without limitation, any proposal or offer to Parent Stockholders) with respect to a merger, acquisition, consolidation, recapitalization, reorganization, liquidation, tender offer or exchange offer or similar transaction involving, or any purchase of 25% or more of the consolidated assets of, or any equity interest representing 25% or more of the outstanding shares of capital stock in, Parent.

“Parent Benefit Plan” and “Parent Benefit Plans” have the respective meanings set forth in §4(o)(i) below.

“Parent Board” means the board of directors of Parent.

“Parent Contracts” has the meaning set forth in §4(t) below.

“Parent Disclosure Letter” has the meaning set forth in §4(a) below.

“Parent Employees” has the meaning set forth in §4(o)(i) below.

“Parent ERISA Affiliate” has the meaning set forth in §4(o)(iii) below.

“Parent Fairness Opinion” means an opinion of ING Barings LLC, addressed to the Parent Board, as to the fairness of the Merger to Parent from a financial point of view.

“Parent Intellectual Property” has the meaning set forth in §4(r) below.

“Parent Material Adverse Effect” has the meaning set forth in §4(a) below.

“Parent Pension Plan” has the meaning set forth in §4(o)(ii) below.

“Parent Reports” has the meaning set forth in §4(g) below.

“Parent Shares” has the meaning set forth in the preambles.

“Parent Special Meeting” has the meaning set forth in §5(c)(ii) below.

“Parent Stockholder” means any Person who or which holds any Parent Shares.

“Parent Subsidiary” has the meaning set forth in the preambles.

“Parent Superior Proposal” has the meaning set forth in §5(i)(ii) below.

“Parent Third Party” means any Person (or group of Persons) other than the Company or its respective Affiliates.

“Party” has the meaning set forth in the preambles.

“Person” means an individual, a partnership, a corporation, a limited liability company, an association, a joint stock company, a trust, a joint venture, an unincorporated organization or a governmental entity (or any department, agency or political subdivision thereof).

“Per Share Merger Consideration” has the meaning set forth in §2(d)(v) below.

“Prior Consultation” means oral or written notice to the chief executive officer of the Company at least two (2) days (one of which must be a business day) prior to the earlier of (x) taking the action or (y) committing to take the action with respect to which Prior Consultation is necessary pursuant to §5(e) below and subsequent to such notice making the chief executive officer of Parent reasonably available to the chief executive officer of the Company to discuss such action prior to taking such action.

“Prohibited Parent Acquisition Proposal” has the meaning set forth in §5(i)(i) below.

“Representatives” has the meaning set forth in §5(h)(i) below.

“Registration Statement” has the meaning set forth in §5(c)(i) below.

“Required Company Consent” has the meaning set forth in §3(f) below.

“Required Parent Consent” has the meaning set forth in §4(f) below.

“Requisite Stockholder Approval” means, with respect to the Company, the affirmative vote of the holders of the outstanding Company Shares in favor of the adoption of this Agreement in accordance with the Delaware General Corporation Law or, with respect to Parent, the affirmative vote of the holders of the outstanding Parent Shares in favor of (a) approval of the issuance of Parent Shares in connection with the Merger as provided in this Agreement in accordance with the rules of Nasdaq and (b) if, necessary, an amendment to Parent’s certificate of incorporation to increase the authorized capital stock of Parent in accordance with the Delaware General Corporation Law.

“SEC” means the Securities and Exchange Commission.

“Securities Act” means the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder.

“Securities Exchange Act” means the Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder.

“Security Interest” means any mortgage, pledge, lien, encumbrance, charge or other security interest, other than (a) mechanic’s, materialman’s and similar liens; (b) liens for taxes not yet due and payable or for taxes that the taxpayer is contesting in good faith through appropriate proceedings; (c) purchase money liens and liens securing rental payments under capital lease arrangements; and (d) other liens arising in the ordinary course of business and not incurred in connection with the borrowing of money.

“Stock Rights” means each option, warrant, purchase right, subscription right, conversion right, exchange right or other contract, commitment or security providing for the issuance or sale of any capital stock, or otherwise causing to become outstanding any capital stock, including with respect to the Company, the right of holders of Nonvoting Shares to exchange such shares for Voting Shares.

“Stockholder” has the meaning set forth in the preambles.

“Stockholder Agreement” has the meaning set forth in the preambles.

“Subsidiary” of a specified Person means any corporation, limited liability company, partnership, joint venture or other legal entity of which the specified Person (either alone or together with any other Subsidiary of the specified Person) owns, directly or indirectly, more than 50% of the stock or other equity, partnership, limited liability company or equivalent interests, the holders of which are generally entitled to vote for the election of the board of directors or other governing body of such corporation or other legal entity, or otherwise has the

power to vote or direct the voting of sufficient securities to elect a majority of such board of directors or other governing body.

“Superior Proposal” has the meaning set forth in §5(h)(ii) below.

“Surviving Corporation” has the meaning set forth in §2(a) below.

“Tax Return” means any report, return, declaration or other information required to be supplied to a taxing authority in connection with Taxes.

“Taxes” means all taxes or other like assessments including, without limitation, income, withholding, gross receipts, excise, ad valorem, real or personal property, asset, sales, use, license, payroll, transaction, capital, net worth and franchise taxes imposed by or payable to any federal, state, county, local or foreign government, taxing authority, subdivision or agency thereof, including interest, penalties, additions to tax or additional amounts thereto.

“Third Party” means any Person (or group of Persons) other than Parent or its respective Affiliates.

“Voting Shares” has the meaning set forth in the preambles.

“Year 2000 Compliant” has the meaning set forth in §3(q) below.

2. The Transaction.

(a) The Merger. On and subject to the terms and conditions of this Agreement, the Parent Subsidiary will merge with and into the Company at the Effective Time. The Company shall be the corporation surviving the Merger (the “Surviving Corporation”).

(b) The Closing. The closing of the transactions contemplated by this Agreement (the “Closing”) shall take place at the offices of Kelley Drye & Warren LLP, 101 Park Avenue, New York, New York, commencing at 9:00 a.m. local time on the third business day following the satisfaction or waiver of all conditions to the obligations of the Parties to consummate the transactions contemplated hereby (other than conditions with respect to actions the respective Parties will take at the Closing itself) or such other date as the Parties may mutually determine (the “Closing Date”).

(c) Actions at the Closing. At the Closing, (i) the Company will deliver to Parent and the Parent Subsidiary the various certificates, instruments and documents referred to in §6(a) below; (ii) Parent and the Parent Subsidiary will deliver to the Company the various certificates, instruments and documents referred to in §6(b) below; (iii) the Company and the Parent Subsidiary will file with the Secretary of State of the State of Delaware a Certificate of Merger in the form attached hereto as Exhibit A (the “Certificate of Merger”); and (iv) Parent will deliver or cause to be delivered the Exchange Fund to the Exchange Agent in the manner provided below in this §2.

(d) Effect of Merger.

(i) General. The Merger shall become effective at the time (the "Effective Time") the Company and the Parent Subsidiary file the Certificate of Merger with the Secretary of State of the State of Delaware or at such later time as the Parties may agree and specify in the Certificate of Merger. The Merger shall have the effects set forth in the Delaware General Corporation Law. The Surviving Corporation may, at any time after the Effective Time, take any action (including executing and delivering any document) in the name and on behalf of either the Company or the Parent Subsidiary in order to carry out and effectuate the transactions contemplated by this Agreement.

(ii) Certificate of Incorporation. At the Effective Time, the certificate of incorporation of the Surviving Corporation shall be amended to read in its entirety in the form of Exhibit B and, as so amended, shall be the certificate of incorporation of the Surviving Corporation until thereafter amended in accordance with its terms and as provided by law.

(iii) By-laws. The By-laws of the Surviving Corporation shall be amended and restated at and as of the Effective Time to read in their entirety as did the By-laws of the Parent Subsidiary in effect immediately prior to the Effective Time and shall be the By-laws of the Surviving Corporation (except that the name of the Surviving Corporation will be changed to a name designated by Parent prior to the Effective Time) until amended in accordance with their terms and as provided by law.

(iv) Directors and Officers. The directors and officers of the Parent Subsidiary immediately prior to the Effective Time shall be the directors and officers of the Surviving Corporation at and as of the Effective Time (retaining their respective positions and terms of office), until the earlier of their respective resignation, removal or otherwise ceasing to be a director or officer, respectively, or until their respective successors are duly elected and qualified, as the case may be.

(v) Conversion of Company Shares. At and as of the Effective Time, (A) each issued and outstanding Company Share (other than any Company Shares owned by Parent, the Parent Subsidiary or the Company) shall be converted into the right to receive 0.445 Parent Shares (the "Per Share Merger Consideration"), and all such Company Shares shall no longer be outstanding, shall be canceled and shall cease to exist, and each holder of a certificate representing any such Company Shares shall thereafter cease to have any rights with respect to such Company Shares, except the right to receive the Per Share Merger Consideration for each such Company Share and any unpaid dividends and distributions, if any, to which the holder of such Company Shares is entitled pursuant to §2(e) upon the surrender of such certificate in accordance with §2(e) below (collectively, the "Merger Consideration"), *provided, however,* that the Per Share Merger Consideration shall be subject to proportionate adjustment in the event of any

stock split, stock dividend or reverse stock split, and (B) each Company Share owned by Parent, Parent Subsidiary or the Company shall be canceled without payment therefor. No Company Share shall be deemed to be outstanding or to have any rights other than those set forth above in this §2(d)(v) after the Effective Time. Notwithstanding anything to the contrary in this §2(d)(v), no fractional Parent Shares shall be issued to then former holders of Company Shares. In lieu thereof, each then former holder of a Company Share who would otherwise have been entitled to receive a fraction of a Parent Share (after taking into account all certificates delivered by such then former holder at any one time) shall receive an amount in cash equal to such fraction of a Parent Share multiplied by the Closing Sales Price per Parent Share on the date of the Effective Time.

(vi) Conversion of Stock Rights. The Company shall take all such action as may be necessary to cause, at the Effective Time, each Stock Right (but excluding rights of holders of Nonvoting Shares to exchange such shares for Voting Shares) granted by the Company to purchase Company Shares which is outstanding and unexercised immediately prior thereto (whether or not vested or exercisable), to be converted automatically into an equivalent Stock Right to purchase Parent Shares in an amount and at an exercise price determined as follows:

(x) The number of Parent Shares to be subject to the new Stock Right shall be equal to the product of the number of Company Shares subject to the original Stock Right multiplied by the Per Share Merger Consideration, provided that any fractional Parent Shares resulting from such multiplication shall be rounded as provided in the instrument governing such Stock Right or, if there is no such instrument, up to the next whole share; and

(y) The exercise price per Parent Share under the new Stock Right shall be equal to the quotient of the exercise price per Company Share under the original Stock Right divided by the Per Share Merger Consideration, provided that the exercise price resulting from such division shall be rounded as provided in the instrument governing such Stock Right or, if there is no such instrument, up to the next whole cent.

The adjustments provided herein with respect to any original Stock Rights which are "incentive stock options" (as defined in Section 422 of the Code) shall be and are intended to be effected in a manner which is consistent with Section 424(a) of the Code. The option plan of the Company under which the original Stock Rights were issued shall be assumed by Parent, and the duration and other terms of the new Stock Rights shall be the same as the original Stock Rights, except that all references to the Company shall be deemed to be references to Parent. At the Effective Time, Parent shall deliver to then former holders of original Stock Rights appropriate agreements representing the right to acquire Parent Shares on the terms and conditions set forth in this § 2(d)(vi).

The Parent shall take all corporate action necessary to reserve for issuance a sufficient number of Parent Shares for delivery upon exercise of the new Stock Rights in accordance with this § 2(d)(vi). At the Effective Time, Parent shall file a registration statement on Form S-8 (or any successor form) or another appropriate form, and seek to cause such Form S-8 to become effective at or as soon as practicable after the Effective Time, with respect to Parent Shares subject to new employee stock options included in the Stock Rights and shall use reasonable efforts to maintain the effectiveness of such registration statement or registration statements (and maintain the current status of the prospectus or prospectuses contained therein) for so long as such options remain outstanding. With respect to those individuals who subsequent to the Merger will be subject to the reporting requirements under Section 16(a) of the Securities Exchange Act, Parent shall administer the option plans assumed pursuant to this § 2(d)(vi) in a manner that complies with Rule 16b-3 promulgated under the Securities Exchange Act to the extent the Company option plan complied with such rule prior to the Merger. Prior to the Effective Time, Parent shall take all actions as may be required to cause the acquisition of equity securities of Parent, as contemplated by this § 2(d)(vi), by any Person who is or will become a director or officer of Parent to be eligible for exemption under Rule 16b-3(d) promulgated under the Securities Exchange Act.

(vii) Conversion of Capital Stock of the Parent Subsidiary. At and as of the Effective Time, each share of common stock, \$.01 par value per share, of the Parent Subsidiary shall be converted into one share of common stock, \$.01 par value per share, of the Surviving Corporation.

(e) Procedure for Exchange.

(i) Immediately after the Effective Time, (A) Parent will furnish to The Bank of New York, its transfer agent, or such other bank or trust company reasonably acceptable to the Company, to act as exchange agent (the “Exchange Agent”) a corpus (the “Exchange Fund”) consisting of Parent Shares and cash sufficient to permit the Exchange Agent to make full payment of the Merger Consideration to the holders of all of the issued and outstanding Company Shares (other than any Company Shares owned by Parent, Parent Subsidiary or the Company), and (B) Parent will cause the Exchange Agent to mail a letter of transmittal (with instructions for its use) in a form to be mutually agreed upon by the Company and Parent prior to Closing to each holder of issued and outstanding Company Shares (other than any Company Shares owned by Parent, the Parent Subsidiary or the Company) for the holder to use in surrendering the certificates which, immediately prior to the Effective Time, represented his or its Company Shares against payment of the Merger Consideration to which such holder is entitled pursuant to §2(d)(v). Upon surrender to the Exchange Agent of such certificates, together with such letter of transmittal, duly executed and completed in accordance with the instructions thereto, Parent shall promptly cause to be issued a certificate representing that number of whole Parent Shares and a check representing the amount of cash in lieu of any fractional shares and unpaid

dividends and distributions, if any, to which such Persons are entitled, after giving effect to any required tax withholdings. No interest will be paid or accrued on the cash in lieu of fractional shares and unpaid dividends and distributions, if any, payable to recipients of Parent Shares. If payment is to be made to a Person other than the registered holder of the certificate surrendered, it shall be a condition of such payment that the certificate so surrendered shall be properly endorsed or otherwise in proper form for transfer and that the Person requesting such payment shall pay any transfer or other taxes required by reason of the payment to a Person other than the registered holder of the certificate surrendered or establish to the reasonable satisfaction of the Surviving Corporation or the Exchange Agent that such tax has been paid or is not applicable. In the event any certificate representing Company Shares shall have been lost, stolen or destroyed, upon the making of an affidavit of that fact by the Person claiming such certificate to be lost, stolen or destroyed, the Exchange Agent will issue in exchange for such lost, stolen or destroyed certificate the Merger Consideration deliverable in respect thereof; *provided, however*, the Person to whom such Merger Consideration is paid shall, as a condition precedent to the payment thereof, give the Surviving Corporation a bond in such sum as it may direct or otherwise indemnify the Surviving Corporation in a manner reasonably satisfactory to it against any claim that may be made against the Surviving Corporation with respect to the certificate alleged to have been lost, stolen or destroyed. No dividends or other distributions declared after the Effective Time with respect to Parent Shares and payable to the holders of record thereof shall be paid to the holder of any unsurrendered certificate until the holder thereof shall surrender such certificate in accordance with this §2(e). After the surrender of a certificate in accordance with this §2(e), the record holder thereof shall be entitled to receive any such dividends or other distributions, without any interest thereon, which theretofore had become payable with respect to the Parent Shares represented by such certificate. No holder of an unsurrendered certificate shall be entitled, until the surrender of such certificate, to vote the Parent Shares into which his or its Company Shares shall have been converted into the right to receive.

(ii) The Company will cause its transfer agent to furnish promptly to the Parent Subsidiary a list, as of a recent date, of the record holders of Company Shares and their addresses, as well as mailing labels containing the names and addresses of all record holders of Company Shares and lists of security positions of Company Shares held in stock depositories. The Company will furnish the Parent Subsidiary with such additional information (including, but not limited to, updated lists of holders of Company Shares and their addresses, mailing labels and lists of security positions) and such other assistance as Parent or the Parent Subsidiary or their agents may reasonably request.

(iii) The Parent may cause the Exchange Agent to invest the cash included in the Exchange Fund in one or more investments selected by Parent; *provided, however*, that the terms and conditions of the investments shall be such as to permit the Exchange Agent to make prompt payment of the Merger Consideration as necessary. The Parent may cause the Exchange Agent to pay

over to the Surviving Corporation any net earnings with respect to the investments, and Parent will replace promptly any portion of the Exchange Fund which the Exchange Agent loses through investments.

(iv) The Parent may cause the Exchange Agent to pay over to the Surviving Corporation any portion of the Exchange Fund (including any earnings thereon) remaining 180 days after the Effective Time, and thereafter all former stockholders of the Company shall be entitled to look to the Surviving Corporation (subject to abandoned property, escheat and other similar laws) as general creditors thereof with respect to the Per Share Merger Consideration and any cash payable upon surrender of their certificates.

(v) The Parent shall pay, or shall cause the Surviving Corporation to pay, all charges and expenses of the Exchange Agent.

(f) Closing of Transfer Records. After the Effective Time, no transfer of Company Shares outstanding prior to the Effective Time shall be made on the stock transfer books of the Surviving Corporation. If, after the Effective Time, certificates representing such shares are presented for transfer to the Exchange Agent, they shall be canceled and exchanged for certificates representing Parent Shares, cash in lieu of fractional shares, if any, and unpaid dividends and distributions, if any, as provided in §2(e).

(g) Dissenters' Rights. The holders of Nonvoting Shares as to which dissenters' rights shall have been duly demanded under applicable law (the "Dissenting Shares"), if any, shall be entitled to payment by the Surviving Corporation only of the fair value of such Nonvoting Shares plus accrued interest to the extent permitted by and in accordance with the provisions of applicable law; *provided, however*, that (i) if any holder of Dissenting Shares shall, under the circumstances permitted by applicable law, subsequently deliver a written withdrawal of such holder's demand or (ii) if any holder fails to establish such holder's entitlement to rights of payment as provided under applicable law, such holder or holders (as the case may be) shall forfeit such right to payment for such Nonvoting Shares and such Nonvoting Shares shall thereupon be deemed to have been converted into Parent Shares as of the Effective Time.

3. Representations and Warranties of the Company. The Company represents and warrants to Parent and the Parent Subsidiary:

(a) Organization, Qualification and Corporate Power. The Company is a corporation duly organized, validly existing and in good standing under the laws of Delaware. If applicable to such country, each of the Company's Subsidiaries operating in such country has been duly incorporated or otherwise organized, is validly existing and, in jurisdictions where the concept is applicable, in good standing under the laws of the jurisdiction of its incorporation or organization. Each of the Company and its Subsidiaries is duly authorized to conduct business and is in good standing under the laws of each jurisdiction where such qualification is required, except where the lack of such qualification or failure to be in good standing would not reasonably be expected to have a material adverse effect on the business, financial condition or results of operations of the Company and its Subsidiaries taken as a whole or on the ability of the Company to consummate the transactions contemplated by this Agreement (a "Company

Material Adverse Effect”). Each of the Company and its Subsidiaries has full corporate power and corporate authority, and all foreign, federal, state and local governmental permits, licenses and consents, required to carry on the businesses in which it is engaged and to own and use the properties owned and used by it, except for such permits, licenses and consents the failure of which to have would not reasonably be expected to have a Company Material Adverse Effect. The Company does not own any equity interest in any corporation, partnership, limited liability company, joint venture or other legal entity other than the Subsidiaries listed in §3(a) of the Company Disclosure Letter accompanying this Agreement (the “Company Disclosure Letter”).

(b) Capitalization. The entire authorized capital stock of the Company consists of 2,500,000 shares of preferred stock, \$.01 par value per share, none of which are issued and outstanding as of August 26, 1999, 75,000,000 Voting Shares, of which 31,226,052 Voting Shares were issued and outstanding as of August 26, 1999 and no Voting Shares were held in treasury as of August 26, 1999, and 500,000 Nonvoting Shares, of which 99,929 Nonvoting Shares were issued and outstanding as of August 26, 1999 and no Nonvoting Shares were held in treasury as of August 26, 1999. All of the issued and outstanding Company Shares have been duly authorized and are validly issued, fully paid and nonassessable, and none have been issued in violation of any preemptive or similar right. As of August 26, 1999, 155,000 warrants of the Company were outstanding, each such warrant entitling the holder thereof to purchase 8.485 Voting Shares at an exercise price of \$0.01 per Voting Share (the “Warrants”). As of August 26, 1999, 1,315,148 Voting Shares were subject to issuance pursuant to the Warrants and 6,652,923 Voting Shares were subject to issuance pursuant to employee stock options issued under Company Benefit Plans. Except as set forth above, neither the Company nor any of its Subsidiaries has any outstanding or authorized Stock Rights. Except for stock appreciation rights authorized under Company Benefit Plans, of which none are outstanding as of August 26, 1999, there are no outstanding or authorized stock appreciation, phantom stock, profit participation or similar rights with respect to the Company or any of its Subsidiaries. Except as set forth in §3(b) of the Company Disclosure Letter, there are no rights, contracts, commitments or arrangements obligating the Company to redeem, purchase or acquire, or offer to purchase, redeem or acquire, any outstanding shares of, or any outstanding options, warrants or rights of any kind to acquire any shares of, or any outstanding securities that are convertible into or exchangeable for any shares of, capital stock of the Company.

(c) Subsidiaries. The Company owns, directly or indirectly, 100% of the outstanding shares of capital stock of each of its Subsidiaries free and clear of any Security Interest and each such share of capital stock has been duly authorized and is validly issued, fully paid and nonassessable, and none of such shares of capital stock has been issued in violation of any preemptive or similar right. No shares of capital stock of, or other equity interests in, any Subsidiary of the Company are reserved for issuance, and there are no contracts, agreements, commitments or arrangements obligating the Company or any of its Subsidiaries (i) to offer, sell, issue, grant, pledge, dispose of or encumber any shares of capital stock of, or other equity interests in, or any options, warrants or rights of any kind to acquire any shares of capital stock of, or other equity interests in, any of the Subsidiaries of the Company or (ii) to redeem, purchase or acquire, or offer to purchase or acquire, any outstanding shares of capital stock of, or other equity interests in, or any outstanding options, warrants or rights of any kind to acquire any shares of capital stock of, or other equity interest in, or any outstanding securities that are

convertible into or exchangeable for, any shares of capital stock of, or other equity interests in, any of the Subsidiaries of the Company.

(d) Voting Arrangements. Except as set forth in §3(d) of the Company Disclosure Letter or in Company Reports filed prior to the date hereof, there are no voting trusts, proxies or other similar agreements or understandings to which the Company or any of its Subsidiaries is a party or by which the Company or any of its Subsidiaries is bound with respect to the voting of any shares of capital stock of the Company or any of its Subsidiaries or with respect to the registration of the offering, sale or delivery of any shares of capital stock of the Company or any of its Subsidiaries under the Securities Act. There are no issued or outstanding bonds, debentures, notes or other indebtedness of the Company having the right to vote on any matters on which stockholders of the Company may vote.

(e) Authorization of Transaction. The Company has full power and authority (including full corporate power and corporate authority), and has taken all required action, necessary to properly execute and deliver this Agreement and to perform its obligations hereunder, and this Agreement constitutes the valid and legally binding obligation of the Company, enforceable in accordance with its terms and conditions, except as limited by (i) applicable bankruptcy, insolvency, reorganization, moratorium and other laws of general application affecting enforcement of creditors' rights generally and (ii) general principles of equity, regardless of whether asserted in a proceeding in equity or at law; *provided, however*, that the Company cannot consummate the Merger unless and until it receives the Requisite Stockholder Approval of the Company Stockholders.

(f) Noncontravention. Neither the execution and the delivery of this Agreement, nor the consummation of the transactions contemplated hereby, will (i) violate any constitution, statute, regulation, rule, injunction, judgment, order, decree or other restriction of any government, governmental agency or court of competent jurisdiction (a "Government Entity") to which the Company or any of its Subsidiaries is subject or any provision of the charter or by-laws of the Company or any of its Subsidiaries or (ii) conflict with, result in a breach of, constitute a default under, result in the acceleration of, create in any party the right to accelerate, terminate, modify or cancel or require any notice under any agreement, contract, lease, license, instrument or other arrangement to which the Company or any of its Subsidiaries is a party or by which it is bound or to which any of its assets is subject, except where the violation, conflict, breach, default, acceleration, termination, modification, cancellation, or failure to give notice would not reasonably be expected to have a Company Material Adverse Effect or except as set forth in §3(f) of the Company Disclosure Letter. Other than as required under the provisions of the Hart-Scott-Rodino Act, Foreign Competition Laws, the Delaware General Corporation Law, Nasdaq, the Securities Exchange Act, the Securities Act and state securities laws, neither the Company nor any of its Subsidiaries needs to give any notice to, make any filing with or obtain any authorization, consent or approval of any Government Entity in order for the Parties to consummate the transactions contemplated by this Agreement, except where the failure to give notice, to file or to obtain any authorization, consent or approval would not reasonably be expected to have a Company Material Adverse Effect or except as set forth in §3(f) of the Company Disclosure Letter. "Required Company Consents" means any authorization, consent or approval of a Government Entity or other Third Party required to be obtained pursuant to any Foreign Competition Laws or state securities laws or so that a matter set

forth in §3(f) of the Company Disclosure Letter would not be reasonably expected to have a Company Material Adverse Effect for purposes of this §3(f).

(g) Filings with the SEC. The Company has made all filings with the SEC that it has been required to make under the Securities Act and the Securities Exchange Act (collectively, the "Company Reports"). Each of the Company Reports has complied with the Securities Act and the Securities Exchange Act in all material respects. None of the Company Reports, as of their respective dates, contained any untrue statement of a material fact or omitted to state a material fact necessary in order to make the statements made therein, in light of the circumstances under which they were made, not misleading.

(h) Financial Statements.

(i) The Company has filed an Annual Report on Form 10-K (the "Company 10-K") for the fiscal year ended December 31, 1998 and a Quarterly Report on Form 10-Q (the "Company 10-Q") for the fiscal quarter ended June 30, 1999. The financial statements included in the Company 10-K and the Company 10-Q (including the related notes and schedules) have been prepared from the books and records of the Company and its Subsidiaries in accordance with GAAP applied on a consistent basis throughout the periods covered thereby, and present fairly in all material respects the financial condition of the Company and its Subsidiaries as of the indicated dates and the results of operations and cash flows of the Company and its Subsidiaries for the periods set forth therein, (subject in the case of quarterly financial statements to the absence of complete footnotes and subject to normal year-end audit adjustments).

(ii) From June 30, 1999 until the date of this Agreement, the Company and its Subsidiaries have not incurred any liabilities that are of a nature that would be required to be disclosed on a balance sheet of the Company and its Subsidiaries or the footnotes thereto prepared in conformity with GAAP, other than (A) liabilities incurred in the ordinary course of business or (B) liabilities that would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect or (C) liabilities disclosed in §3(h) of the Company Disclosure Letter or in Company Reports filed prior to the date hereof.

(i) Events Subsequent to June 30, 1999. From June 30, 1999 to the date of this Agreement, except as disclosed in the Company Reports filed prior to the date hereof or except as set forth in §3(i) of the Company Disclosure Letter, (i) the Company and its Subsidiaries have conducted their respective businesses only in, and have not engaged in any transaction other than according to, the ordinary and usual course of such businesses, and (ii) there has not been (A) any change in the financial condition, business or results of operations of the Company or any of its Subsidiaries, or any development or combination of developments relating to the Company or any of its Subsidiaries of which management of the Company has knowledge, and which would reasonably be expected to have a material adverse effect upon the business, financial condition or results of operations of the Company and its Subsidiaries taken as a whole; (B) any declaration, setting aside or payment of any dividend or other distribution with respect to the capital stock of the Company, or any redemption, repurchase or other

reacquisition of any of the capital stock of the Company; (C) any change by the Company in accounting principles, practices or methods materially affecting the reported consolidated assets, liabilities or results of operations of the Company; (D) any increase in the compensation of any officer of the Company or any of its Subsidiaries or grant of any general salary or benefits increase to the employees of the Company or any of its Subsidiaries other than in the ordinary course of business consistent with past practices; (E) any issuance or sale of any capital stock or other securities (including any Stock Rights) by the Company or any of its Subsidiaries of any kind, other than upon exercise of Stock Rights issued by or binding upon the Company; (F) any modification, amendment or change to the terms or conditions of any Stock Right; or (G) any split, combination, reclassification, redemption, repurchase or other reacquisition of any capital stock or other securities of the Company or any of its Subsidiaries.

(j) Compliance. Except as set forth in §3(j) of the Company Disclosure Letter or in Company Reports filed prior to the date hereof, the Company and its Subsidiaries are in compliance with all applicable foreign, federal, state and local laws, rules and regulations except where the failure to be in compliance would not reasonably be expected to have a Company Material Adverse Effect.

(k) Brokers' and Other Fees. Except as set forth in §3(k) of the Company Disclosure Letter, none of the Company and its Subsidiaries has any liability or obligation to pay any fees or commissions to any broker, finder or agent with respect to the transactions contemplated by this Agreement.

(l) Litigation and Liabilities. Except as disclosed in §3(l) of the Company Disclosure Letter or in Company Reports filed prior to the date hereof, there are (i) no actions, suits or proceedings pending or, to the knowledge of the management of the Company, threatened against the Company or any of its Subsidiaries, or any facts or circumstances known to the management of the Company which may give rise to an action, suit or proceeding against the Company or any of its Subsidiaries, which (x) would reasonably be expected to have a Company Material Adverse Effect, and (ii) no obligations or liabilities of the Company or any of its Subsidiaries, whether accrued, contingent or otherwise, known to the management of the Company which would reasonably be expected to have a material adverse effect upon the business, financial condition or results of operations of the Company and its Subsidiaries taken as a whole.

(m) Taxes. Except as set forth in §3(m) of the Company Disclosure Letter or in Company Reports filed prior to the date hereof, the Company and each of its Subsidiaries have duly filed or caused to be duly filed on their behalf all federal, state, local and foreign Tax Returns required to be filed by them, and have duly paid, caused to be paid or made adequate provision for the payment of all Taxes required to be paid in respect of the periods covered by such Tax Returns, except where the failure to file such Tax Returns or to pay such Taxes would not reasonably be expected to have a material adverse effect upon the business, financial condition or results of operations of the Company and its Subsidiaries taken as a whole. Except as set forth in §3(m) of the Company Disclosure Letter, no claims for Taxes have been asserted against the Company or any of its Subsidiaries and no material deficiency for any Taxes has been proposed, asserted or assessed which has not been resolved or paid in full. To the knowledge of the Company's management, no Tax Return or taxable period of the Company or any of its

Subsidiaries is under examination by any taxing authority, and neither the Company nor any of its Subsidiaries has received written notice of any pending audit by any taxing authority. There are no outstanding agreements or waivers extending the statutory period of limitation applicable to any Tax Return for any period of the Company or any of its Subsidiaries. Except as set forth in §3(m) of the Company Disclosure Letter, there are no tax liens other than liens for Taxes not yet due and payable relating to the Company or any of its Subsidiaries. The Company has no reason to believe that any conditions exist that could reasonably be expected to prevent the Merger from qualifying as a reorganization within the meaning of Section 368(a) of the Code. Except as provided in §3(m) of the Company Disclosure Letter, neither the Company nor any of its Subsidiaries is a party to any agreement or contract which would result in payment of any "excess parachute payment," within the meaning of Section 280G of the Code, as of the date of this Agreement. Neither the Company nor any of its Subsidiaries has filed any consent pursuant to Section 341(f) of the Code or agreed to have Section 341(f)(2) of the Code apply to any disposition of a subsection (f) asset owned by the Company or any of its Subsidiaries. The Company has not been and is not a United States real property holding company (as defined in Section 897(c)(2) of the Code) during the applicable period specified in Section 897(c)(1)(A)(ii) of the Code. None of the Company or its Subsidiaries (x) has been a member of an "affiliated group," within the meaning of Section 1504(a) of the Code, other than a group the common parent of which was the Company or (y) has any liability for the Taxes of any person, other than any of the Company or its Subsidiaries under Treasury Regulation §1.1502-6 (or any similar provision of state, local or foreign law) as a transferee, successor, by contract or otherwise.

(n) Fairness Opinion. Morgan Stanley & Co. Incorporated has delivered to the Company Board the Company Fairness Opinion, and a true and complete copy thereof has been furnished to Parent.

(o) Employee Benefits.

(i) All material pension, profit-sharing, deferred compensation, savings, stock bonus and stock option plans, and all employee benefit plans, whether or not covered by the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), which are sponsored by the Company or any Company ERISA Affiliate (as defined below) of the Company or to which the Company or any Company ERISA Affiliate of the Company makes contributions, and which cover employees of the Company (the "Company Employees") or former employees of the Company, all employment or severance contracts with employees of the Company or its Subsidiaries who receive more than \$75,000 in total cash compensation per annum, and any applicable "change of control" or similar provisions in any plan, contract or arrangement that cover Company Employees (collectively, "Company Benefit Plans" and individually a "Company Benefit Plan") are accurately and completely listed in §3(o) of the Company Disclosure Letter. No Company Benefit Plan is a multi-employer plan, money purchase plan, defined benefit plan, multiple employer plan or multiple employer welfare arrangement and no Company Benefit Plan is covered by Title IV of ERISA. True and complete copies of all Company Benefit Plans (other than medical and other similar welfare plans made generally available to all Company Employees) have been made available to Parent.

(ii) All Company Benefit Plans to the extent subject to ERISA, are in compliance in all material respects with ERISA and the rules and regulations promulgated thereunder. Each Company Benefit Plan which is an "employee pension benefit plan" within the meaning of Section 3(2) of ERISA ("Company Pension Plan") and which is intended to be qualified under Section 401(a) of the Internal Revenue Code of 1986, as amended (the "Code"). has received a favorable determination letter from the Internal Revenue Service, which determination letter is currently in effect, and there are no proceedings pending or, to the knowledge of the management of the Company, threatened, or any facts or circumstances known to the management of the Company, which are reasonably likely to result in revocation of any such favorable determination letter. There is no pending or, to the knowledge of the management of the Company, threatened litigation relating to the Company Benefit Plans. Neither the Company nor any of its Subsidiaries has engaged in a transaction with respect to any Company Benefit Plan that, assuming the taxable period of such transaction expired as of the date hereof, is reasonably likely to subject the Company or any of its Subsidiaries to a tax or penalty imposed by either Section 4975 of the Code or Section 502(i) of ERISA.

(iii) No liability under Title IV of ERISA has been or is reasonably likely to be incurred by the Company or any of its Subsidiaries with respect to any ongoing, frozen or terminated Company Benefit Plan that is a "single-employer plan", within the meaning of Section 4001(a)(15) of ERISA, currently or formerly maintained by any of them, or the single-employer plan of any entity which is considered a predecessor of the Company or one employer with the Company under Section 4001 of ERISA (a "Company ERISA Affiliate"). All contributions required to be made under the terms of any Company Benefit Plan have been timely made or reserves therefor on the balance sheet of the Company have been established, which reserves are adequate. Except as required by Part 6 of Title I of ERISA, the Company does not have any unfunded obligations for retiree health and life benefits under any Company Benefit Plan.

(p) Delaware General Corporation Law. For purposes of Section 203 of the Delaware General Corporation Law, the execution and delivery of this Agreement and the Stockholder Agreements and consummation of transactions contemplated hereby and thereby, including without limitation the purchase by Parent of Company Shares or other securities issued by the Company, has received the prior approval of the Board of Directors of the Company and, accordingly, Parent will not be subject to the restrictions of Section 203(b) of the Delaware General Corporation Law in the consummation of the Merger or this Agreement or the Stockholder Agreements or the transactions contemplated by either thereof.

(q) Year 2000. Except as disclosed in the previously filed Company Reports, the Company's products and information systems are Year 2000 Compliant except to the extent that their failure to be Year 2000 Compliant would not, individually or in the aggregate, reasonably be expected to have a material adverse effect on the business, financial condition or results of operations of the Company and its Subsidiaries taken as a whole. For purposes of this Agreement, "Year 2000 Compliant" shall mean that a Person's products and information systems

accurately process date/time data (including, but not limited to, calculating, comparing and sequencing) from, into and between the twentieth and twenty-first centuries, and the years 1999 and 2000 and leap year calculations.

(r) Environmental Matters. Except for such matters that, individually or in the aggregate, are not reasonably likely to have a material adverse effect on the business, financial condition or results of operations of the Company and its Subsidiaries taken as a whole, or would not otherwise require disclosure pursuant to the Securities Exchange Act, or are listed in §3(r) of the Company Disclosure Letter or described in Company Reports filed prior to the date hereof, (i) each of the Company and its Subsidiaries has complied and is in compliance with all applicable Environmental Laws (as defined below); (ii) the properties currently owned or operated by the Company or any of its Subsidiaries (including soils, groundwater, surface water, buildings or other structures) are not contaminated with Hazardous Substances (as defined below); (iii) neither the Company nor any of its Subsidiaries is subject to liability for any Hazardous Substance disposal or contamination on any third party property; (iv) neither the Company nor any of its Subsidiaries has had any release or threat of release of any Hazardous Substance; (v) neither the Company nor any of its Subsidiaries has received any notice, demand, threat, letter, claim or request for information alleging that it or any of its Subsidiaries may be in violation of or liable under any Environmental Law (including any claims relating to electromagnetic fields or microwave transmissions); (vi) neither the Company nor any of its Subsidiaries is subject to any orders, decrees, injunctions or other arrangements with any governmental or regulatory authority of competent jurisdiction or is subject to any indemnity or other agreement with any third party relating to liability under any Environmental Law or relating to Hazardous Substances; and (vii) there are no circumstances or conditions involving the Company or any of its Subsidiaries that would reasonably be expected to result in any claims, liabilities, investigations, costs or restrictions on the ownership, use or transfer of any of its properties pursuant to any Environmental Law.

As used herein, the term "Environmental Law" means any federal, state, local, foreign or other law (including common law), statutes, ordinances or codes relating to: (i) the protection, investigation or restoration of the environment, health, safety or natural resources, (ii) the handling, use, presence, disposal, release or threatened release of any Hazardous Substance, or (iii) noise, odor, wetlands, pollution, contamination or any injury or threat of injury to person or property in connection with any Hazardous Substance.

As used herein, the term "Hazardous Substances" means any substance that is listed, classified or regulated pursuant to any Environmental Law, including any petroleum product or by-product, asbestos-containing material, lead-containing paint or plumbing, polychlorinated biphenyls, radioactive materials or radon.

(s) Intellectual Property. Except as disclosed in §3(s) of the Company Disclosure Letter or in the Company Reports filed prior to the date hereof, the Company and its Subsidiaries have all right, title and interest in, or a valid and binding license to use, all Company Intellectual Property (as defined below). Except as disclosed in §3(s) of the Company Disclosure Letter or in the Company Reports filed prior to the date hereof, the Company and its Subsidiaries (i) have not defaulted in any material respect under any license to use any Company Intellectual Property, (ii) are not the subject of any proceeding or litigation for infringement of

any third party intellectual property. (iii) have no knowledge of circumstances that would be reasonably expected to give rise to any such proceeding or litigation and (iv) have no knowledge of circumstances that are causing or would be reasonably expected to cause the loss or impairment of any Company Intellectual Property, other than a default, proceeding, litigation, loss or impairment that is not having or would not be reasonably expected to have, individually or in the aggregate, a material adverse effect on the business, financial condition or results of operation of the Company and its Subsidiaries taken as a whole.

For purposes of this Agreement, "Company Intellectual Property" means patents and patent rights, trademarks and trademark rights, trade names and trade name rights, service marks and service mark rights, copyrights and copyright rights, trade secret and trade secret rights, and other intellectual property rights, and all pending applications for and registrations of any of the foregoing that are individually or in the aggregate material to the conduct of the business of the Company and its Subsidiaries taken as a whole.

(t) Insurance. Except as set forth in §3(t) of the Company Disclosure Letter, each of the Company and its Subsidiaries is insured with financially responsible insurers in such amounts and against such risks and losses as are customary for companies conducting the business as conducted by the Company and its Subsidiaries during such time period.

(u) Certain Contracts. Except as set forth in §3(u) of the Company Disclosure Letter, all material contracts to which the Company or any of its Subsidiaries is a party or may be bound that are required by Item 610(b)(10) of Regulation S-K to be filed as exhibits to, or incorporated by reference in, the Company 10-K or the Company 10-Q have been so filed or incorporated by reference. All material contracts to which the Company or any of its Subsidiaries is a party or may be bound that have been entered into as of the date hereof and will be required by Item 610(b)(10) of Regulation S-K to be filed or incorporated by reference into the Company's Quarterly Report on Form 10-Q for the period ending September 30, 1999, but which have not previously been filed or incorporated by reference into any Company Report, are set forth in §3(u) of the Company Disclosure Letter. All contracts, licenses, consents, royalty or other agreements which are material to the Company and its Subsidiaries, taken as a whole, to which the Company or any of its Subsidiaries is a party (the "Company Contracts") are valid and in full force and effect on the date hereof except to the extent they have previously expired in accordance with their terms or, to the extent such invalidity would not reasonably be expected to have a material adverse effect on the business, financial condition or results of operations of the Company and its Subsidiaries taken as a whole and, to the Company's knowledge, neither the Company nor any of its Subsidiaries has violated any provision of, or committed or failed to perform any act which with or without notice, lapse of time or both would constitute a default under the provisions of, any Company Contract, except for defaults which individually and in the aggregate would not reasonably be expected to result in a material adverse effect on the business, financial condition or results of operations of the Company and its Subsidiaries taken as a whole.

4. Representations and Warranties of Parent and the Parent Subsidiary. Each of Parent and the Parent Subsidiary represents and warrants to the Company:

(a) Organization, Qualification and Corporate Power. Each of Parent and Parent Subsidiary has been duly incorporated and is validly existing as a corporation in good

standing under the laws of the State of Delaware. If applicable to such country, each of Parent's Subsidiaries operating in such country has been duly incorporated or otherwise organized, is validly existing and, in jurisdictions where the concept is applicable, in good standing under the laws of the jurisdiction of its incorporation or organization. Each of Parent and its Subsidiaries is duly authorized to conduct business and, if applicable to such country, is in good standing under the laws of each jurisdiction where such qualification is required, except where the lack of such qualification or failure to be in good standing would not reasonably be expected to have a material adverse effect on the business, financial condition or results of operations of Parent and its Subsidiaries taken as a whole or on the ability of the Parties to consummate the transactions contemplated by this Agreement (a "Parent Material Adverse Effect"). Each of Parent and its Subsidiaries has full corporate power and corporate authority, and all foreign, federal, state and local governmental permits, licenses and consents, required to carry on the businesses in which it is engaged and to own and use the properties owned and used by it, except for such permits, licenses and consents the failure of which to have would not reasonably be expected to have a Parent Material Adverse Effect. Parent does not own any equity interest in any corporation, partnership, limited liability company, joint venture or other entity other than the Subsidiaries listed in §4(a) of Parent's disclosure letter accompanying this Agreement (the "Parent Disclosure Letter").

(b) Capitalization. The entire authorized capital stock of Parent consists of 1,281,958 shares of preferred stock, \$.01 par value per share, none of which are issued and outstanding, and 50,000,000 Parent Shares, of which 32,601,087 Parent Shares were issued and outstanding as of August 23, 1999 and no Parent Shares were held in treasury on August 23, 1999. All of the issued and outstanding Parent Shares have been duly authorized and are validly issued, fully paid and nonassessable, and none have been issued in violation of any preemptive or similar right. Except as set forth in §4(b) of the Parent Disclosure Letter, neither Parent nor any of its Subsidiaries has any outstanding or authorized Stock Rights. There are no outstanding or authorized stock appreciation, phantom stock, profit participation or similar rights with respect to Parent or any of its Subsidiaries. There are no rights, contracts, commitments or arrangements obligating Parent or any of its Subsidiaries to redeem, purchase or acquire, or offer to purchase, redeem or acquire, any outstanding shares of, or any outstanding options, warrants or rights of any kind to acquire any shares of, or any outstanding securities that are convertible into or exchangeable for any shares of, capital stock of Parent.

(c) Subsidiaries. Except as set forth in §4(a) of the Parent Disclosure Letter, Parent, directly or indirectly, owns 100% of the outstanding shares of capital stock of each of its Subsidiaries free and clear of any Security Interest and each such share of capital stock has been duly authorized and is validly issued, fully paid and nonassessable, and none of such shares of capital stock has been issued in violation of any preemptive or similar right. No shares of capital stock of, or other equity interests in, any Subsidiary of Parent are reserved for issuance, and there are no contracts, agreements, commitments or arrangements obligating Parent or any of its Subsidiaries (i) to offer, sell, issue, grant, pledge, dispose of or encumber any shares of capital stock of, or other equity interests in, or any options, warrants or rights of any kind to acquire any shares of capital stock of, or other equity interests in, any of the Subsidiaries of Parent or (ii) to redeem, purchase or acquire, or offer to purchase or acquire, any outstanding shares of capital stock of, or other equity interests in, or any outstanding options, warrants or rights of any kind to acquire any shares of capital stock of, or other equity interest in, or any outstanding securities

that are convertible into or exchangeable for, any shares of capital stock of, or other equity interests in, any of the Subsidiaries of Parent.

(d) Voting Arrangements. There are no voting trusts, proxies or other similar agreements or understandings to which Parent or any of its Subsidiaries is a party or by which Parent or any of its Subsidiaries is bound with respect to the voting of any shares of capital stock of Parent or any of its Subsidiaries. There are no issued or outstanding bonds, debentures, notes or other indebtedness of Parent having the right to vote on any matters on which stockholders of Parent may vote.

(e) Authorization of Transaction. Each of Parent and the Parent Subsidiary has full power and authority (including full corporate power and corporate authority), and has taken all required action, necessary to properly execute and deliver this Agreement and to perform its obligations hereunder, and this Agreement constitutes the valid and legally binding obligation of each of Parent and the Parent Subsidiary, enforceable in accordance with its terms and conditions, except as limited by (i) applicable bankruptcy, insolvency, reorganization, moratorium and other laws of general application affecting enforcement of creditors' rights generally and (ii) general principles of equity, regardless of whether asserted in a proceeding in equity or at law; provided, however, that Parent cannot consummate the Merger unless and until it receives the Requisite Stockholder Approval of the Parent Stockholders.

(f) Noncontravention. Neither the execution and the delivery of this Agreement, nor the consummation of the transactions contemplated hereby, will (i) violate any constitution, statute, regulation, rule, injunction, judgment, order, decree or other restriction of any Government Entity to which Parent or any of its Subsidiaries is subject or any provision of the charter or by-laws of Parent or any of its Subsidiaries or (ii) conflict with, result in a breach of, constitute a default under, result in the acceleration of, create in any party the right to accelerate, terminate, modify or cancel or require any notice under any agreement, contract, lease, license, instrument or other arrangement to which either Parent or any of its Subsidiaries is a party or by which it is bound or to which any of its assets is subject, except in the case of clause (ii) where the violation, conflict, breach, default, acceleration, termination, modification, cancellation or failure to give notice would not reasonably be expected to have a Parent Material Adverse Effect. Other than as required under the provisions of the Hart-Scott-Rodino Act, Foreign Competition Laws, Nasdaq, the Securities Exchange Act, the Securities Act and state securities laws, neither Parent nor any of its Subsidiaries needs to give any notice to, make any filing with or obtain any authorization, consent or approval of any Government Entity in order for the Parties to consummate the transactions contemplated by this Agreement, except where the failure to give notice, to file or to obtain any authorization, consent or approval would not reasonably be expected to have a Parent Material Adverse Effect or except as set forth in §4(f) of the Parent Disclosure Letter. "Required Parent Consents" means any authorization, consent or approval of a Government Entity or other Third Party required to be obtained pursuant to any Foreign Competition Laws or state securities laws or so that a matter set forth in § 4(f) of the Parent Disclosure Letter would not be reasonably expected to have a Parent Material Adverse Effect for purposes of this §4(f).

(g) Filings with the SEC. Parent has made all filings with the SEC that it has been required to make under the Securities Act and the Securities Exchange Act (collectively,

the "Parent Reports"). Each of the Parent Reports has complied with the Securities Act and the Securities Exchange Act in all material respects. None of the Parent Reports, as of their respective dates, contained any untrue statement of a material fact or omitted to state a material fact necessary in order to make the statements made therein, in light of the circumstances under which they were made, not misleading.

(h) Financial Statements.

(i) Parent has filed an Annual Report on Form 10-K (the "Parent 10-K") for the fiscal year ended December 31, 1998 and a Quarterly Report on Form 10-Q (the "Parent 10-Q") for the fiscal quarter ended June 30, 1999. The financial statements included in the Parent 10-K and the Parent 10-Q (including the related notes and schedules) have been prepared from the books and records of Parent and its Subsidiaries in accordance with GAAP applied on a consistent basis throughout the periods covered thereby, and present fairly in all material respects the financial condition of Parent and its Subsidiaries as of the indicated dates and the results of operations and cash flows of Parent and its Subsidiaries for the periods set forth therein, (subject in the case of quarterly financial statements to the absence of complete footnotes and subject to normal year-end audit adjustments).

(ii) From June 30, 1999 until the date of this Agreement, Parent and its Subsidiaries have not incurred any liabilities that are of a nature that would be required to be disclosed on a balance sheet of Parent and its Subsidiaries or the footnotes thereto prepared in conformity with GAAP, other than (A) liabilities incurred in the ordinary course of business or (B) liabilities that would not, individually or in the aggregate, reasonably be expected to have a Parent Material Adverse Effect or (C) liabilities disclosed in §4(h) of the Parent Disclosure Letter or in Parent Reports filed prior to the date hereof.

(i) Events Subsequent to June 30, 1999. From June 30, 1999 to the date of this Agreement, except as disclosed in the Parent Reports filed prior to the date hereof or except as set forth in § 4(i) of the Parent Disclosure Letter, (i) Parent and its Subsidiaries have conducted their respective businesses only in, and have not engaged in any transaction other than according to, the ordinary and usual course of such businesses, and (ii) there has not been (A) any change in the financial condition, business or results of operations of Parent or any of its Subsidiaries, or any development or combination of developments relating to Parent or any of its Subsidiaries of which management of Parent has knowledge, and which would reasonably be expected to have a material adverse effect upon the business, financial condition or results of operations of Parent and its Subsidiaries taken as a whole; (B) any declaration, setting aside or payment of any dividend or other distribution with respect to the capital stock of Parent, or any redemption, repurchase or other reacquisition of any of the capital stock of Parent; (C) any change by Parent in accounting principles, practices or methods; (D) any increase in the compensation of any officer of Parent or any of its Subsidiaries or grant of any general salary or benefits increase to the employees of Parent or any of its Subsidiaries other than in the ordinary course of business consistent with past practices; (E) any issuance or sale of any capital stock or other securities (including any Stock Rights) by Parent or any of its Subsidiaries of any kind,

other than upon exercise of Stock Rights issued by or binding upon Parent: (F) any modification, amendment or change to the terms or conditions of any Stock Right; or (G) any split, combination, reclassification, redemption, repurchase or other reacquisition of any capital stock or other securities of Parent or any of its Subsidiaries.

(j) Compliance. Except as set forth in §4(j) of the Parent Disclosure Letter or in Parent Reports filed prior to the date hereof, Parent and its Subsidiaries are in compliance with all applicable foreign, federal, state and local laws, rules and regulations except where the failure to be in compliance would not reasonably be expected to have a Parent Material Adverse Effect.

(k) Brokers' and Other Fees. Except as set forth in §4(k) of the Parent Disclosure Letter, none of Parent and its Subsidiaries has any liability or obligation to pay any fees or commissions to any broker, finder or agent with respect to the transactions contemplated by this Agreement.

(l) Litigation and Liabilities. Except as disclosed in §4(l) of the Parent Disclosure Letter or in Parent Reports filed prior to the date hereof, there are (i) no actions, suits or proceedings pending or, to the knowledge of the management of Parent, threatened against Parent or any of its Subsidiaries, or any facts or circumstances known to the management of Parent which may give rise to an action, suit or proceeding against Parent or any of its Subsidiaries, which (x) would reasonably be expected to have a Parent Material Adverse Effect and (ii) no obligations or liabilities of Parent or any of its Subsidiaries, whether accrued, contingent or otherwise, known to the management of Parent which would reasonably be expected to have a material adverse effect upon the business, financial condition or results of operations of Parent and its Subsidiaries taken as a whole.

(m) Taxes. Except as set forth in §4(m) of the Parent Disclosure Letter or in Parent Reports filed prior to the date hereof, Parent and each of its Subsidiaries have duly filed or caused to be duly filed on their behalf all federal, state, local and foreign Tax Returns required to be filed by them, and have duly paid, caused to be paid or made adequate provision for the payment of all Taxes required to be paid in respect of the periods covered by such Tax Returns, except where the failure to file such Tax Returns or pay such Taxes would not reasonably be expected to have a material adverse effect upon the business, financial condition or results of operations of Parent and its Subsidiaries taken as a whole. Except as set forth in §4(m) of the Parent Disclosure Letter, no claims for Taxes have been asserted against Parent or any of its Subsidiaries and no material deficiency for any Taxes has been proposed, asserted or assessed which has not been resolved or paid in full. To the knowledge of Parent's management, no Tax Return or taxable period of Parent or any of its Subsidiaries is under examination by any taxing authority, and neither Parent nor any of its Subsidiaries has received written notice of any pending audit by any taxing authority. There are no outstanding agreements or waivers extending the statutory period of limitation applicable to any Tax Return for any period of Parent or any of its Subsidiaries. Except as set forth in §4(m) of the Parent Disclosure Letter, there are no tax liens other than liens for Taxes not yet due and payable relating to Parent or any of its Subsidiaries. Parent has no reason to believe that any conditions exist that could reasonably be expected to prevent the Merger from qualifying as a reorganization within the meaning of Section 368(a) of the Code. Neither Parent nor any of its Subsidiaries is a party to any agreement or contract which would result in payment of any "excess parachute payment" within

the meaning of Section 280G of the Code as a result of the transactions contemplated hereby. Neither Parent nor any of its Subsidiaries has filed any consent pursuant to Section 341(f) of the Code or agreed to have Section 341(f)(2) of the Code apply to any disposition of a subsection (f) asset owned by Parent or any of its Subsidiaries. Parent has not been and is not a United States real property holding company (as defined in Section 897(c)(2) of the Code) during the applicable period specified in Section 897(c)(1)(A)(ii) of the Code. None of Parent or its Subsidiaries (x) has been a member of an "affiliated group," within the meaning of Section 1504(a) of the Code, other than a group the common parent of which was Parent or (y) has any liability for the Taxes of any person, other than any of Parent or its Subsidiaries under Treasury Regulation §1.1502-6 (or any similar provision of state, local or foreign law) as a transferee, successor, by contract or otherwise.

(n) Fairness Opinion. ING Barings LLC has delivered to the Parent Board the Parent Fairness Opinion, and a true and complete copy thereof has been furnished to the Company.

(o) Employee Benefits.

(i) All pension, profit-sharing, deferred compensation, savings, stock bonus and stock option plans, and all employee benefit plans, whether or not covered by ERISA which are sponsored by Parent or any Parent ERISA Affiliate (as defined below) of Parent or to which Parent or any Parent ERISA Affiliate of Parent makes contributions, and which cover employees of Parent (the "Parent Employees") or former employees of Parent, all employment or severance contracts with executive officers of Parent, and any applicable "change of control" or similar provisions in any plan, contract or arrangement that cover Employees (collectively, "Parent Benefit Plans" and individually a "Parent Benefit Plan") are accurately and completely listed in §4(o) of the Parent Disclosure Letter. No Parent Benefit Plan is a multi-employer plan, money purchase plan, defined benefit plan, multiple employer plan or multiple employer welfare arrangement and no Parent Benefit Plan is covered by Title IV of ERISA. True and complete copies of all Parent Benefit Plans (other than medical and other similar welfare plans made generally available to all Parent Employees) have been made available to the Company.

(ii) All Parent Benefit Plans to the extent subject to ERISA, are in compliance in all material respects with ERISA and the rules and regulations promulgated thereunder. Each Parent Benefit Plan which is an "employee pension benefit plan" within the meaning of Section 3(2) of ERISA ("Parent Pension Plan") and which is intended to be qualified under Section 401(a) of the Code, has received a favorable determination letter from the Internal Revenue Service, which determination letter is currently in effect, and there are no proceedings pending or, to the knowledge of the management of Parent, threatened, or any facts or circumstances known to the management of Parent, which are reasonably likely to result in revocation of any such favorable determination letter. There is no pending or, to the knowledge of the management of Parent, threatened litigation relating to the Parent Benefit Plans. Neither Parent

nor any of its Subsidiaries has engaged in a transaction with respect to any Parent Benefit Plan that, assuming the taxable period of such transaction expired as of the date hereof, is reasonably likely to subject Parent or any of its Subsidiaries to a tax or penalty imposed by either Section 4975 of the Code or Section 502(i) of ERISA.

(iii) No liability under Title IV of ERISA has been or is reasonably likely to be incurred by Parent or any of its Subsidiaries with respect to any ongoing, frozen or terminated Parent Benefit Plan that is a "single-employer plan", within the meaning of Section 4001(a)(15) of ERISA, currently or formerly maintained by any of them, or the single-employer plan of any entity which is considered a predecessor of Parent or one employer with Parent under Section 4001 of ERISA (a "Parent ERISA Affiliate"). All contributions required to be made under the terms of any Parent Benefit Plan have been timely made or reserves therefor on the balance sheet of Parent have been established, which reserves are adequate. Except as required by Part 6 of Title I of ERISA, Parent does not have any unfunded obligations for retiree health and life benefits under any Parent Benefit Plan.

(p) Year 2000. Except as disclosed in the previously filed Parent Reports, Parent's products and information systems are Year 2000 Compliant except to the extent that their failure to be Year 2000 Compliant would not, individually or in the aggregate, reasonably be expected to have a material adverse effect on the business, financial condition or results of operations of Parent and its Subsidiaries taken as a whole.

(q) Environmental Matters. Except for such matters that, individually or in the aggregate, are not reasonably likely to have a material adverse effect on the business, financial condition or results of operations of Parent and its Subsidiaries taken as a whole, or would not otherwise require disclosure pursuant to the Securities Exchange Act, or are listed in §4(q) of the Parent Disclosure Letter or described in Parent Reports filed prior to the date hereof, (i) each of Parent and its Subsidiaries has complied and is in compliance with all applicable Environmental Laws; (ii) the properties currently owned or operated by Parent or any of its Subsidiaries (including soils, groundwater, surface water, buildings or other structures) are not contaminated with Hazardous Substances (as defined below); (iii) neither Parent nor any of its Subsidiaries is subject to liability for any Hazardous Substance disposal or contamination on any third party property; (iv) neither Parent nor any of its Subsidiaries has had any release or threat of release of any Hazardous Substance; (v) neither Parent nor any of its Subsidiaries has received any notice, demand, threat, letter, claim or request for information alleging that it or any of its Subsidiaries may be in violation of or liable under any Environmental Law (including any claims relating to electromagnetic fields or microwave transmissions); (vi) neither Parent nor any of its Subsidiaries is subject to any orders, decrees, injunctions or other arrangements with any governmental or regulatory authority of competent jurisdiction or is subject to any indemnity or other agreement with any third party relating to liability under any Environmental Law or relating to Hazardous Substances; and (vii) there are no circumstances or conditions involving Parent or any of its Subsidiaries that could reasonably be expected to result in any claims, liabilities, investigations, costs or restrictions on the ownership, use or transfer of any of its properties pursuant to any Environmental Law.

(r) Intellectual Property. Except as disclosed in §4(r) of the Parent Disclosure Letter or in the Parent Reports filed prior to the date hereof, Parent and its Subsidiaries have all right, title and interest in, or a valid and binding license to use, all Parent Intellectual Property (as defined below). Except as disclosed in §4(r) of the Parent Disclosure Letter or in the Parent Reports filed prior to the date hereof, Parent and its Subsidiaries (i) have not defaulted in any material respect under any license to use any Parent Intellectual Property, (ii) are not the subject of any proceeding or litigation for infringement of any third party intellectual property, (iii) have no knowledge of circumstances that would be reasonably expected to give rise to any such proceeding or litigation and (iv) have no knowledge of circumstances that are causing or would be reasonably expected to cause the loss or impairment of any Parent Intellectual Property, other than a default, proceeding, litigation, loss or impairment that is not having or would not be reasonably expected to have, individually or in the aggregate, a material adverse effect on the business, financial condition or results of operation of Parent and its Subsidiaries taken as a whole.

For purposes of this Agreement, "Parent Intellectual Property" means patents and patent rights, trademarks and trademark rights, trade names and trade name rights, service marks and service mark rights, copyrights and copyright rights, trade secret and trade secret rights, and other intellectual property rights, and all pending applications for and registrations of any of the foregoing that are individually or in the aggregate material to the conduct of the business of Parent and its Subsidiaries taken as a whole.

(s) Insurance. Except as set forth in §4(s) of the Parent Disclosure Letter, each of Parent and its Subsidiaries is insured with financially responsible insurers in such amounts and against such risks and losses as are customary for companies conducting the business as conducted by Parent and its Subsidiaries during such time period.

(t) Certain Contracts. Except as set forth in §4(t) of the Parent Disclosure Letter, all material to which Parent or any of its Subsidiaries is a party or may be bound that are required by Item 610(b)(10) of Regulation S-K to be filed as exhibits to, or incorporated by reference in, the Parent 10-K or the Parent 10-Q have been so filed or incorporated by reference. All material contracts to which Parent or any of its Subsidiaries is a party or may be bound that have been entered into as of the date hereof and will be required by Item 610(b)(10) of Regulation S-K to be filed or incorporated by reference into Parent's Quarterly Report on Form 10-Q for the period ending September 30, 1999, but which have not previously been filed or incorporated by reference into any Parent Reports, are set forth in §4(t) of the Parent Disclosure Letter. All contracts, licenses, consents, royalty or other agreements which are material to Parent and its Subsidiaries, taken as a whole, to which Parent or any of its Subsidiaries is a party (the "Parent Contracts") are valid and in full force and effect on the date hereof except to the extent they have previously expired in accordance with their terms or, to the extent such invalidity would not reasonably be expected to have a material adverse effect on the business, financial condition or results of operations of Parent and its Subsidiaries taken as a whole and, to Parent's knowledge, neither Parent nor any of its Subsidiaries has violated any provision of, or committed or failed to perform any act which with or without notice, lapse of time or both would constitute a default under the provisions of, any Parent Contract, except for defaults which individually and in the aggregate would not reasonably be expected to result in a material adverse effect on the

business, financial condition or results of operations of Parent and its Subsidiaries taken as a whole.

(u) Activities of Parent Subsidiary. Since the date of its incorporation, Parent Subsidiary has not carried on any business or conducted any operations other than the execution of this Agreement, the performance of its obligations hereunder and matters ancillary thereto. Parent Subsidiary has a positive net worth under GAAP.

(v) Circe. Parent and/or its Subsidiaries have all Circe Rights necessary for the operation of Rings 1 and 2 of the Circe Network, except to the extent the failure to have any such Circe Rights, would not, in the aggregate, be reasonably expected to have a Parent Material Adverse Effect. All material Circe Rights relating to Rings 1 and 2 have terms or are renewable without material cost, for the entire expected useful life of such rings. To Parent's knowledge, as of the date of this Agreement, there is no existing or anticipated fact or circumstance that would be reasonably expected to cause a material delay in the scheduled in-service date of Circe Rings 3, 4 or 5 as described in the most recent Parent Reports filed prior to the date hereof.

5. Covenants. The Parties agree as follows with respect to the period from and after the execution of this Agreement through and including the Effective Time (except for §5(j), §5(l) and §5(q), which will apply from and after the Effective Time in accordance with their respective terms and §5(p) which will apply from the date hereof and shall survive after the Closing).

(a) General. Each of the Parties will use all reasonable efforts to take all actions and to do all things necessary in order to consummate and make effective the transactions contemplated by this Agreement (including satisfaction, but not waiver, of the closing conditions set forth in §6 below).

(b) Notices and Consents. The Company and Parent will give any notices (and will cause each of their respective Subsidiaries to give any notices) to third parties, and will use all reasonable efforts to obtain (and will cause each of their respective Subsidiaries to use all reasonable efforts to obtain) any third-party consents, that may be required in connection with the matters referred to in §3(f) and §4(f) above (regardless of whether the failure to give such notice or obtain such consent would result in a Company Material Adverse Effect or a Parent Material Adverse Effect).

(c) Regulatory Matters and Approvals. Each of the Parties, promptly after the date hereof, will (and the Company, promptly after the date hereof, will cause each of its Subsidiaries to) give any notices to, make any filings with and use all reasonable efforts to obtain any authorizations, consents and approvals of Government Entities in connection with the matters referred to in §3(f) and §4(f) above. Without limiting the generality of the foregoing:

(i) Federal Securities Laws. As promptly as practicable following the date hereof, Parent and the Parent Subsidiary shall, in cooperation with the Company, prepare and file with the SEC preliminary proxy materials which shall constitute the Joint Proxy Statement/Prospectus (such proxy statement/prospectus, and any amendments or supplements thereto, the "Joint Proxy Statement/Prospectus") and a registration statement on Form S-4 with respect to

the issuance of Parent Shares in connection with the Merger (the "Registration Statement"), and file with state securities administrators such registration statements or other documents as may be required under applicable blue sky laws to qualify or register such Parent Shares in such states as are designated by the Company (the "Blue Sky Filings"). The Joint Proxy Statement/Prospectus will be included in the Registration Statement as Parent's prospectus. The Registration Statement and the Joint Proxy Statement/Prospectus shall comply as to form in all material respects with the applicable provisions of the Securities Act and the Exchange Act and the rules and regulations thereunder. Each of Parent and the Parent Subsidiary shall use all reasonable efforts to have the Registration Statement declared effective by the SEC as promptly as practicable after filing with the SEC and to keep the Registration Statement effective as long as is necessary to consummate the Merger. Parent and the Parent Subsidiary agree that none of the information supplied or to be supplied by Parent or the Parent Subsidiary for inclusion or incorporation by reference in the Registration Statement and/or the Joint Proxy Statement/Prospectus and each amendment or supplement thereto, at the time of mailing thereof and at the time of the Company Special Meeting (as defined below) or the Parent Special Meeting (as defined below), will contain an untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading. The Company agrees that none of the information supplied or to be supplied by the Company for inclusion or incorporation by reference in the Joint Proxy Statement/Prospectus and each amendment or supplement thereto, at the time of mailing thereof and at the time of the Company Special Meeting or the Parent Special Meeting, will contain an untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading. For purposes of the foregoing, it is understood and agreed that information concerning or related to Parent and the Parent Special Meeting will be deemed to have been supplied by Parent and information concerning or related to the Company and the Company Special Meeting shall be deemed to have been supplied by the Company. Parent will provide the Company with a reasonable opportunity to review and comment on the Joint Proxy Statement/Prospectus and any amendment or supplement thereto prior to filing such with the SEC, will provide the Company with a copy of all such filings made with the SEC and will notify the Company as promptly as practicable after the receipt of any comments from the SEC or its staff or from any state securities administrators and of any request by the SEC or its staff or by any state securities administrators for amendments or supplements to the Registration Statement or any Blue Sky Filings or for additional information, and will supply the Company and its legal counsel with copies of all correspondence between Parent or any of its representatives, on the one hand, and the SEC, its staff or any state securities administrators, on the other hand, with respect to the Registration Statement. No change, amendment or supplement to the information supplied by the Company for inclusion in the Joint Proxy Statement/Prospectus shall be made without the

approval of the Company, which approval shall not be unreasonably withheld or delayed. If, at any time prior to the Effective Time, any event relating to the Company or Parent or any of their respective Affiliates, officers or directors is discovered by the Company or Parent, as the case may be, that is required by the Securities Act, the Securities Exchange Act, or the rules or regulations thereunder, to be set forth in an amendment to the Registration Statement or a supplement to the Joint Proxy Statement/Prospectus, the Company or Parent, as the case may be, will as promptly as practicable inform the other, and such amendment or supplement will be promptly filed with the SEC and disseminated to the stockholders of the Company and Parent, to the extent required by applicable securities laws. All documents which the Company or Parent files or is responsible for filing with the SEC and any other regulatory agency in connection with the Merger (including, without limitation, the Registration Statement and the Joint Proxy Statement/Prospectus) will comply as to form and content in all material respects with the provisions of applicable law. Notwithstanding the foregoing, the Company, on the one hand, and Parent and the Parent Subsidiary, on the other hand, make no representations or warranties with respect to any information that has been supplied in writing by the other, or the other's auditors, attorneys or financial advisors, specifically for use in the Registration Statement or the Joint Proxy Statement/Prospectus, or in any other documents to be filed with the SEC or any other regulatory agency expressly for use in connection with the transactions contemplated hereby.

(ii) Delaware General Corporation Law. The Company will take all action, to the extent necessary in accordance with applicable law, its certificate of incorporation and by-laws to convene a special meeting of its stockholders (the "Company Special Meeting"), as soon as reasonably practicable in order that the stockholders may consider and vote upon the adoption of this Agreement and the approval of the Merger in accordance with the Delaware General Corporation Law. Parent will take all action, to the extent necessary in accordance with applicable law, its certificate of incorporation and by-laws to convene a special meeting of its stockholders (the "Parent Special Meeting"), as soon as reasonably practicable in order that the stockholders may consider and vote upon the issuance of Parent Shares in connection with the Merger as provided in the Agreement as required by the rules of Nasdaq and, if necessary, an amendment to the certificate of incorporation of Parent to increase the number of authorized Parent Shares. The Company and Parent shall mail the Joint Proxy Statement/Prospectus to their respective stockholders simultaneously and as soon as reasonably practicable. Subject to §5(h)(iv) and §5(i)(iv) below, the Joint Proxy Statement/Prospectus shall contain the affirmative unanimous recommendations of the Company Board in favor of the adoption of this Agreement and the approval of the Merger and of the Parent Board in favor of issuance of Parent Shares in connection with the Merger as provided in the Agreement as required by the rules of Nasdaq and, if necessary, increase the number of authorized Purchaser Shares in accordance with the Delaware General Corporation Law.

(iii) Hart-Scott-Rodino Act. As soon as possible after the date hereof, each of the Parties will file any Notification and Report Forms and related material that it may be required to file with the Federal Trade Commission and the Antitrust Division of the United States Department of Justice under the Hart-Scott-Rodino Act, will use all reasonable efforts to obtain (and the Company will cause each of its Subsidiaries to use all reasonable efforts to obtain) an early termination of the applicable waiting period, and will make any further filings pursuant thereto that may be necessary.

(iv) Periodic Reports. Parent and the Parent Subsidiary, and their counsel, shall be given an opportunity to review each Form 10-K and Form 10-Q (and any amendments thereto) to be filed by the Company under the Securities Exchange Act prior to their being filed with the SEC and Nasdaq, and shall be provided with final copies thereof concurrently with their filing with the SEC.

(v) Telecommunications Laws. Parent shall be responsible for preparing and filing the appropriate applications, notifications and other documentation necessary or appropriate to request from Government Entities with jurisdiction over the telecommunications industry all necessary authorizations, consents and approvals to the Merger and the transactions contemplated hereby. The Company, at its sole cost and expense, will cooperate with Parent in this regard, providing such assistance as Parent shall reasonably request. Parent shall provide the Company with drafts of all applications and other documents to be filed with any such regulatory authority prior to such filing and shall give Company a reasonable opportunity to review and comment thereon.

(d) Operation of the Company's Business. Except as set forth in §5(d) of the Company Disclosure Letter or as otherwise expressly contemplated by this Agreement, the Company will not (and will not cause or permit any of its Subsidiaries to), without the written consent of Parent, take any action or enter into any transaction other than in the ordinary course of business consistent with past practice. Without limiting the generality of the foregoing, except as expressly provided in this Agreement or §5(d) of the Company Disclosure Letter, without the written consent of Parent:

(i) none of the Company and its Subsidiaries will authorize or effect any change in its charter or by-laws or comparable organizational document;

(ii) none of the Company and its Subsidiaries will grant any Stock Rights or issue, sell, authorize or otherwise dispose of any of its capital stock, (x) except upon the conversion or exercise of Stock Rights outstanding as of the date of this Agreement and (y) except for stock options issued to employees of the Company and its Subsidiaries in a manner consistent with past practice which (I) do not provide for the issuance of more than 250,000 Company Shares in any calendar quarter, (II) are issued only to new employees and employees promoted after the date hereof, (III) are issued at not less than the market price of the Company Stock on the date of grant and (IV) are not issued to any executive officer or director of the Company;

(iii) none of the Company and its Subsidiaries will sell, lease, encumber or otherwise dispose of, or otherwise agree to sell, lease, encumber or otherwise dispose of, any of its assets which are material, individually or in the aggregate, to the Company and its Subsidiaries, taken as a whole;

(iv) none of the Company and its Subsidiaries (other than wholly-owned Subsidiaries) will declare, set aside or pay any dividend or distribution with respect to its capital stock (whether in cash or in kind);

(v) none of the Company and its Subsidiaries will split, combine or reclassify any of its capital stock or redeem, repurchase or otherwise acquire any of its capital stock;

(vi) none of the Company and its Subsidiaries will acquire or agree to acquire by merger or consolidation with, or by purchasing a substantial equity interest in or a substantial portion of the assets of, or by any other manner, any business of any Person or division thereof or otherwise acquire or agree to acquire any assets (other than assets used in the operation of the business of the Company and its Subsidiaries in the ordinary course consistent with past practice);

(vii) none of Company or its Subsidiaries will incur or commit to any capital expenditures other than capital expenditures incurred or committed to in the ordinary course of business consistent with past practice and which, together with all such expenditures incurred or committed since January 1, 1999, are not in excess of the respective amounts by category or in the aggregate set forth in the Company's capital expenditure budget, as previously disclosed to Parent or, if the Closing Date has not occurred prior to December 31, 1999, such additional amounts for any subsequent period as may be consented to by Parent, such consent not to be unreasonably withheld, or, if Parent shall not have so consented, an amount not greater than an amount equal to a pro rata portion of the Company's 1999 capital expenditure budget;

(viii) none of the Company or its Subsidiaries will (x) other than in connection with actions permitted by §5(d)(vi), make any loans, advances or capital contributions to, or investments in, any other Person, other than by the Company or a Subsidiary of the Company to or in the Company or any Subsidiary of the Company and other than loans and advances to employees in an aggregate outstanding amount not to exceed \$100,000 at any time, (y) pay, discharge or satisfy any claims, liabilities or obligations (absolute, accrued, asserted or unasserted, contingent or otherwise), other than payments, discharges or satisfactions incurred or committed to in the ordinary course of business consistent with past practice or (z) other than in connection with actions permitted by §5(d)(vi), create, incur, assume or suffer to exist any indebtedness, issuances of debt securities, guarantees, Security Interests, loans or advances not in existence as of the date of this Agreement except pursuant to the credit facilities, indentures and other arrangements in existence on the date of this Agreement and incurred in the ordinary course of business consistent with past practice, and any

other indebtedness existing on the date of this Agreement, in each case as such credit facilities, indentures, other arrangements and other existing indebtedness may be amended, extended, modified, refunded, renewed or refinanced after the date of this Agreement, but only if the aggregate principal amount thereof is not increased thereby, the term thereof is not extended thereby and the other terms and conditions thereof, taken as a whole, are not less advantageous to the Company and its Subsidiaries than those in existence as of the date of this Agreement;

(ix) none of the Company and its Subsidiaries will make any change in employment terms for any of its directors, officers and employees other than (A) customary increases to employees whose total annual cash compensation is less than \$75,000 awarded in the ordinary course of business consistent with past practices, and (B) customary employee bonuses (including to employees who are officers) approved by the Company Board and paid in the ordinary course of business consistent with past practices and (C) immaterial changes to Company Benefit Plans;

(x) except as disclosed in the Company Reports filed prior to the date of this Agreement, the Company will not change its methods of accounting in effect at June 30, 1999 in a manner materially affecting the consolidated assets, liabilities or results of operations of the Company, except as required by changes in GAAP as concurred in by the Company's independent auditors, and the Company will not (i) change its fiscal year or (ii) make any material tax election, other than in the ordinary course of business consistent with past practice; and

(xi) none of the Company and its Subsidiaries will resolve or commit to any of the foregoing.

In the event the Company shall request Parent to consent in writing to an action otherwise prohibited by this §5(d), Parent shall use reasonable efforts to respond in a prompt and timely fashion (but in no event later than ten (10) business days following such request), but may otherwise respond affirmatively or negatively in its sole discretion.

(e) Operation of Parent's Business. Except as set forth in §5(e) of the Parent Disclosure Letter or as otherwise contemplated by this Agreement:

(i) none of Parent and its Subsidiaries will authorize or effect any change in its charter or by-laws or comparable organizational document except for such amendments to its charter, by-laws or other comparable charter or organizational documents that do not have an adverse affect on the Merger and the other transactions contemplated hereby;

(ii) without Prior Consultation, none of Parent and its Subsidiaries will grant any Stock Rights or issue, sell, authorize or otherwise dispose of any of its capital stock (except (A) employee stock option grants made in the ordinary course consistent with past practice, (B) Stock Rights and capital stock issued as

consideration for acquisitions permitted by §5(e) and (C) upon the conversion or exercise of Stock Rights outstanding as of the date of this Agreement or issued pursuant to the preceding clauses (A) or (B));

(iii) none of Parent and its Subsidiaries will sell or otherwise dispose of, or otherwise agree to sell or otherwise dispose of, in any individual transaction or series of related transactions (other than a capacity or fiber (either lit or dark) sale) any of its assets having a fair market value greater than \$100,000,000;

(iv) none of Parent and its Subsidiaries (other than wholly owned Subsidiaries) will declare, set aside or pay any dividend or distribution with respect to its capital stock (whether in cash or in kind);

(v) none of Parent and its Subsidiaries will split, combine or reclassify any of its capital stock or redeem, repurchase or otherwise acquire any of its capital stock;

(vi) without Prior Consultation, none of Parent or its Subsidiaries will incur or commit to any capital expenditures other than capital expenditures incurred or committed to in the ordinary course of business consistent with past practice;

(vii) none of Parent and its Subsidiaries will acquire or agree to acquire by merger or consolidation with, or by purchasing a substantial equity interest in or a substantial portion of the assets of, or by any other manner, any business of any Person or division thereof or otherwise acquire or agree to acquire any substantial assets in a single transaction or series of related transactions either outside the telecommunications services industry or in a geographic region other than North America and Europe;

(viii) without Prior Consultation, none of Parent and its Subsidiaries will acquire or agree to acquire by merger or consolidation with, or by purchasing a substantial equity interest in or a substantial portion of the assets of, or by any other manner, any business of any Person or division thereof or otherwise acquire or agree to acquire any assets in a single transaction or series of related transactions for consideration having a fair market value in excess of \$50,000,000;

(ix) without Prior Consultation, none of Parent or its Subsidiaries will (x) other than in connection with actions permitted by §5(e)(vii), make any loans, advances or capital contributions to, or investments in, any other Person, other than by Parent or a Subsidiary of Parent to or in Parent or any Subsidiary of Parent, (y) pay, discharge or satisfy any claims, liabilities or obligations (absolute, accrued, asserted or unasserted, contingent or otherwise) in excess of \$25,000,000 in each instance, other than loans, advances, capital contributions, investments, payments, discharges or satisfactions incurred or committed to in the ordinary course of business consistent with past practice or (z) other than in connection

with actions permitted by §5(e)(vii), create, incur, assume or suffer to exist any indebtedness, issuances of debt securities, guarantees, Security Interests, loans or advances not in existence as of the date of this Agreement except pursuant to the credit facilities, indentures and other arrangements in existence on the date of this Agreement and incurred in the ordinary course of business consistent with past practice, and any other indebtedness existing on the date of this Agreement, in each case as such credit facilities, indentures, other arrangements and other existing indebtedness may be amended, extended, exchanged, modified, refunded, renewed or refinanced after the date of this Agreement, but only if the aggregate principal amount thereof is not increased thereby, the term thereof is not extended thereby and the other terms and conditions thereof, taken as a whole, are not less advantageous to Parent and its Subsidiaries than those in existence as of the date of this Agreement;

(x) without Prior Consultation, Parent will not change its methods of accounting in effect at June 30, 1999 in a manner materially affecting the consolidated assets, liabilities or operating results of Parent, except as required by changes in GAAP as concurred in by Parent's independent auditors, and Parent will not (i) change its fiscal year or (ii) make any material tax election, other than in the ordinary course of business consistent with past practice; and

(xi) none of Parent and its Subsidiaries will resolve or commit to any of the foregoing (A) which requires the Company's consent unless it has obtained such consent or (B) which requires Prior Consultation unless it has afforded Prior Consultation.

In the event Parent shall request the Company to consent in writing to an action otherwise prohibited by this § 5(e), the Company shall use reasonable efforts to respond in a prompt and timely fashion (but in no event later than ten (10) business days following such request), but may otherwise respond affirmatively or negatively in its sole discretion.

(f) Access. Each Party will (and will cause each of its Subsidiaries to) permit representatives of the other Party to have access at all reasonable times and in a manner so as not to materially interfere with the normal business operations of the Company and its Subsidiaries, or Parent and its Subsidiaries, as applicable, to all premises, properties, personnel, books, records (including without limitation tax and financial records), contracts and documents of or pertaining to such Party. Each Party and all of its respective representatives will treat and hold as such any Confidential Information it receives from the other Party or any of its representatives in accordance with the Confidentiality Agreement.

(g) Notice of Developments. Each Party will give prompt written notice to the others of any material adverse development causing a breach of any of its own representations and warranties in §3 and §4 above. No disclosure by any Party pursuant to this §5(g), however, shall be deemed to amend or supplement the Company Disclosure Letter or Parent Disclosure Letter or to prevent or cure any misrepresentation, breach of warranty or breach of covenant.

(h) Company Exclusivity.

(i) The Company shall, and shall cause its Subsidiaries and Representatives to, immediately cease and terminate any existing solicitation, initiation, encouragement, activity, discussion or negotiation with any Persons conducted heretofore by the Company, its Subsidiaries or any of their respective Affiliates, officers, directors, employees, financial advisors, agents or representatives (each a "Representative") with respect to any proposed, potential or contemplated Acquisition Proposal.

(ii) From and after the date hereof, without the prior written consent of Parent, the Company will not authorize or permit any of its Subsidiaries to, and shall cause any and all of its Representatives not to, directly or indirectly, (A) solicit, initiate, or encourage any inquiries or proposals that constitute, or could reasonably be expected to lead to, an Acquisition Proposal, or (B) engage in negotiations or discussions with any Third Party concerning, or provide any non-public information to any person or entity relating to, an Acquisition Proposal, or (C) enter into any letter of intent, agreement in principle or any acquisition agreement or other similar agreement with respect to any Acquisition Proposal; *provided, however*, that nothing contained in this §5(h)(ii) shall prevent the Company or the Company Board prior to receipt of the Requisite Stockholder Approval of the Company Stockholders, from furnishing non-public information to, or entering into discussions or negotiations with, any Third Party in connection with an unsolicited, bona fide written proposal for an Acquisition Proposal by such Third Party, if and only to the extent that (1) such Third Party has made a written proposal to the Company Board to consummate an Acquisition Proposal, (2) the Company Board determines in good faith, based upon the advice of a financial advisor of nationally recognized reputation, that such Acquisition Proposal is reasonably capable of being completed on substantially the terms proposed, and would, if consummated, result in a transaction that would provide greater value to the holders of the Company Shares than the transaction contemplated by this Agreement (a "Superior Proposal"), (3) the failure to take such action would, in the reasonable good faith judgment of the Company Board, based upon a written opinion of Company outside legal counsel, be a violation of its fiduciary duties to the Company's stockholders under applicable law, and (4) prior to furnishing such non-public information to, or entering into discussions or negotiations with, such Person, the Company Board receives from such Person an executed confidentiality agreement with material terms no less favorable to the Company than those contained in the Confidentiality Agreement and provides prior notice of its decision to take such action to the Parent. The Company agrees not to release any Third Party from, or waive any provision of, any standstill agreement to which it is a party or any confidentiality agreement between it and another Person who has made, or who may reasonably be considered likely to make, an Acquisition Proposal, unless the failure to take such action would, in the reasonable good faith judgment of the Company Board, based upon written opinion of Company outside legal counsel, be a violation of its fiduciary duties to the Company's stockholders under applicable law and such action is taken prior to

receipt of the Requisite Stockholder Approval of the Company Stockholders. Without limiting the foregoing, it is understood that any violation of the restrictions set forth in the preceding sentence by any Representative of the Company or any of its Subsidiaries shall be deemed to be a breach of this §5(h) by the Company.

(iii) The Company shall notify Parent promptly after receipt by the Company or the Company's knowledge of the receipt by any of its Representatives of any Acquisition Proposal or any request for non-public information in connection with an Acquisition Proposal or for access to the properties, books or records of the Company by any Person that informs such party that it is considering making or has made an Acquisition Proposal. Such notice shall be made orally and in writing and shall indicate the identity of the offeror and the terms and conditions of such proposal, inquiry or contact. The Company shall keep Parent informed of the status (including any change to the material terms) of any such Acquisition Proposal or request for non-public information.

(iv) The Company Board may not withdraw or modify, or propose to withdraw or modify, in a manner adverse to Parent, the approval or recommendation by the Company Board of this Agreement or the Merger unless, following the receipt of a Superior Proposal and prior to receipt of the Requisite Stockholder Approval of the Company Stockholders, in the reasonable good faith judgment of the Company Board, based upon the written opinion of Company's outside legal counsel, the failure to do so would be a violation of the Company Board's fiduciary duties to the Company's stockholders under applicable law; *provided, however*, that, the Company Board shall submit this Agreement and the Merger to the Company's stockholders for adoption and approval, whether or not the Company Board at any time subsequent to the date hereof determines that this Agreement is no longer advisable or recommends that the stockholders of the Company reject it or otherwise modifies or withdraws its recommendation. Unless the Company Board has withdrawn its recommendation of this Agreement in compliance herewith, the Company shall use its best efforts to solicit from the Company stockholders proxies in favor of the adoption and approval of this Agreement and the Merger and to secure the vote or consent of the Company's stockholders required by the Delaware General Corporation Law and its certificate of incorporation and by-laws to adopt and approve this Agreement and the Merger.

(i) Parent Exclusivity.

(i) Parent shall, and shall cause its Subsidiaries and Representatives to, immediately cease and terminate any existing solicitation, initiation, encouragement, activity, discussion or negotiation with any Persons conducted heretofore by Parent, its Subsidiaries or any of its Representatives with respect to any proposed, potential or contemplated Parent Acquisition Proposal the consummation of which would (x) not be consistent with this Agreement or the

Merger and the other transactions contemplated by this Agreement. (y) result in a material delay in the Effective Time or (z) materially and adversely impact the likelihood of obtaining any Required Company Consent or Required Parent Consent other than those the failures to obtain would not result in either a Company Material Adverse Effect or a Parent Material Adverse Effect (a "Prohibited Parent Acquisition Proposal").

(ii) From and after the date hereof, Parent will notify the Company of any Parent Acquisition Proposal of which notice is given to the Parent Board. Such notice to the Company will be made promptly after such notice to the Parent Board, but will be conditional upon an appropriate confidentiality agreement. Without the prior written consent of the Company, Parent will not authorize or permit any of its Subsidiaries to, and shall cause any and all of its Representatives not to, directly or indirectly, (A) solicit, initiate, or encourage any inquiries or proposals that constitute, or could reasonably be expected to lead to, a Prohibited Parent Acquisition Proposal, or (B) engage in negotiations or discussions with any Parent Third Party concerning, or provide any nonpublic information to any person or entity relating to, a Prohibited Parent Acquisition Proposal, or (C) enter into any letter of intent, agreement in principle or any acquisition agreement or other similar agreement with respect to any Prohibited Parent Acquisition Proposal; *provided, however*, that nothing contained in this §5(i)(ii) shall prevent Parent or the Parent Board from, prior to receipt of the Requisite Stockholder Approval of the Parent Stockholders, furnishing nonpublic information to, or entering into discussions or negotiations with, any Parent Third Party in connection with an unsolicited, bona fide written proposal for a Prohibited Parent Acquisition Proposal by such Parent Third Party, if and only to the extent that (1) such Parent Third Party has made a written proposal to the Parent Board to consummate a Prohibited Parent Acquisition Proposal, (2) the Parent Board determines in good faith, based upon the advice of a financial advisor of nationally recognized reputation, that such Prohibited Parent Acquisition Proposal is reasonably capable of being completed on substantially the terms proposed, and would, if consummated, result in a transaction that would provide greater value to the holders of the Parent Shares than the transaction contemplated by this Agreement (a "Parent Superior Proposal"), (3) the failure to take such action would, in the reasonable good faith judgment of the Parent Board, based upon a written opinion of Parent's outside legal counsel, be a violation of its fiduciary duties to the Parent's stockholders under applicable law, and (4) prior to furnishing such nonpublic information to, or entering into discussions or negotiations with, such Person, the Parent Board receives from such Person an executed confidentiality agreement with material terms no less favorable to Parent than those contained in the Confidentiality Agreement. Parent agrees not to release any Parent Third Party from, or waive any provision of, any standstill agreement to which it is a party or any confidentiality agreement between it and another Person who has made, or who may reasonably be considered likely to make, a Prohibited Parent Acquisition Proposal, unless the failure to take such action would, in the reasonable good faith judgment of the Parent Board, based upon the written opinion of Parent's outside legal counsel, be a violation of its

fiduciary duties to the Parent's stockholders under applicable law and such action is taken prior to receipt of the Requisite Stockholder Approval of the Parent Stockholders. Without limiting the foregoing, it is understood that any violation of the restrictions set forth in the preceding sentence by any Representative of Parent or any of its Subsidiaries shall be deemed to be a breach of this §5(i)(ii) by Parent. A Parent Acquisition Proposal shall be deemed a Prohibited Parent Acquisition Proposal at the time (and not before) the Parent Board is first notified of such Parent Acquisition Proposal, and at any time that the Parent Board is notified of a significant development with respect to such Parent Acquisition Proposal, unless the Parent Board in good faith determines that such Parent Acquisition Proposal is not, and is not reasonably likely to become, a Prohibited Parent Acquisition Proposal.

(iii) Parent shall notify the Company promptly after receipt by Parent or Parent's knowledge of the receipt by any of its Representatives of any Prohibited Parent Acquisition Proposal or any request for non-public information in connection with a Prohibited Parent Acquisition Proposal or for access to the properties, books or records of Parent by any Person that informs such party that it is considering making or has made a Prohibited Parent Acquisition Proposal. Such notice shall be made orally and in writing and shall indicate the identity of the offeror and the terms and conditions of such proposal, inquiry or contact. Parent shall keep the Company informed of the status (including any change to the material terms) of any such Prohibited Parent Acquisition Proposal or request for nonpublic information.

(iv) The Parent Board may not withdraw or modify, or propose to withdraw or modify, in a manner adverse to the Company, the approval or recommendation by the Parent Board of this Agreement or the Merger unless, following the receipt of a Parent Superior Proposal but prior to receipt of the Requisite Stockholder Approval of the Parent Stockholders, in the reasonable good faith judgment of the Parent Board, based upon the written opinion of Parent's outside legal counsel, the failure to do so would be a violation of the Parent Board's fiduciary duties to the Parent's stockholders under applicable law; *provided, however*, that the Parent Board shall submit the Merger to Parent's stockholders for adoption and approval, whether or not the Parent Board at any time subsequent to the date hereof determines that this Agreement is no longer advisable or recommends that the stockholders of Parent reject the Merger or otherwise modifies or withdraws its recommendation. Unless the Parent Board has withdrawn its recommendation of the Merger in compliance herewith, Parent shall use its best efforts to solicit from the Parent stockholders proxies in favor of the adoption and approval of the Merger and to secure the vote or consent of Parent's stockholders required by Nasdaq and the Delaware General Corporation Law.

(v) Prior to taking any action with respect to a Parent Acquisition Proposal which is not a Prohibited Parent Acquisition Proposal equivalent to those permitted by clauses (A), (B) or (C) of §5(i)(ii), Parent shall notify each

Parent Third Party which is the object of or a party to such action of the limitation on Prohibited Parent Acquisition Proposals set forth in this §5(i), and Parent shall not enter into any letter of intent, agreement in principle or any acquisition agreement or other similar agreement with respect to any Parent Acquisition Proposal unless such letter or agreement includes a covenant of the applicable Parent Third Party not to take any action which would cause such Parent Acquisition Proposal to become a Prohibited Parent Acquisition Proposal.

(j) Insurance and Indemnification.

(i) Parent will provide each individual who served as a director or officer of the Company at any time prior to the Effective Time with liability insurance for a period of six years after the Effective Time no less favorable in coverage and amount than any applicable insurance of the Company in effect immediately prior to the Effective Time provided, however, if the existing liability insurance expires, or is terminated or canceled by the insurance carrier during such six year period, the Surviving Corporation will use its best efforts to obtain as much liability insurance (no less favorable in coverage) as can be obtained for the remainder of such period for a premium not in excess (on an annualized basis) of 200% of the last annual premium paid prior to the date hereof.

(ii) After the Effective Time, Parent (A) will not take or permit to be taken any action to alter or impair any exculpatory or indemnification provisions now existing in the certificate of incorporation, by-laws or indemnification and employment agreements of the Company or any of its Subsidiaries for the benefit of any individual who served as a director or officer of the Company or any of its Subsidiaries (an "Indemnified Party") at any time prior to the Effective Time (except as may be required by applicable law), and (B) shall cause the Surviving Corporation to honor and fulfill such provisions until the date which is six years from the Effective Time (except as may be required by applicable law); *provided, however*, in the event any claim or claims are asserted within such period, all rights to indemnification in respect of such claim or claims shall continue until the final disposition thereof.

(iii) To the extent clauses (i) and (ii) above shall not serve to indemnify and hold harmless an Indemnified Party, Parent, subject to the terms and conditions of this clause (iii), will indemnify, for a period of six years from the Effective Time, to the fullest extent permitted under applicable law, each Indemnified Party from and against any and all actions, suits, proceedings, hearings, investigations, charges, complaints, claims, demands, injunctions, judgments, orders, decrees, rulings, damages, dues, penalties, fines, costs, amounts paid in settlement, liabilities, obligations, taxes, liens, losses, expenses and fees, including all court costs and reasonable attorneys' fees and expenses, resulting from, arising out of, relating to or caused by this Agreement or any of the transactions contemplated herein; *provided, however*, in the event any claim or claims are asserted or threatened within such six-year period, all rights to

indemnification in respect of any such claim or claims shall continue until final disposition of any and all such claims. Any Indemnified Party wishing to claim indemnification under this clause (iii), notwithstanding anything to the contrary in the provisions set forth in the Company's certificate of incorporation, by-laws or other agreements respecting indemnification of directors or officers, upon learning of any such claim, action, suit, proceeding or investigation, shall promptly notify Parent thereof, but the failure to so notify shall not relieve Parent of any liability it may have to such Indemnified Party if such failure does not materially prejudice Parent. In the event of any such claim, action, suit, proceeding or investigation (whether arising before or after the Effective Time), (A) Parent or the Surviving Corporation shall have the right following the Effective Time to assume the defense thereof and Parent shall not be liable to such Indemnified Parties for any legal expenses of other counsel or any other expenses subsequently incurred by such Indemnified Parties in connection with the defense thereof, except that if Parent or the Surviving Corporation fails to assume such defense or counsel for Parent advises that there are issues which raise conflicts of interest between Parent or the Surviving Corporation, on the one hand, and the Indemnified Parties, on the other hand, the Indemnified Parties may retain counsel satisfactory to them, and the Company, Parent or the Parent Subsidiary shall pay all reasonable fees and expenses of such counsel for the Indemnified Parties promptly as statements therefor are received; *provided, however*, that Parent shall be obligated to pay for only one firm of counsel for all Indemnified Parties in any jurisdiction unless the use of one counsel for such Indemnified Parties would present such counsel with a conflict of interest, in which case Parent need only pay for separate counsel to the extent necessary to resolve such conflict; (B) the Indemnified Parties will reasonably cooperate in the defense of any such matter; and (C) Parent shall not be liable for any settlement effectuated without its prior written consent, which consent shall not be unreasonably withheld or delayed. Parent shall not settle any action or claim identified in this §5(j)(iii) in any manner that would impose any liability or penalty on an Indemnified Party not paid by Parent or the Surviving Corporation without such Indemnified Party's prior written consent, which consent shall not be unreasonably withheld or delayed.

(iv) Notwithstanding anything contained in clause (iii) above, Parent shall not have any obligation hereunder to any Indemnified Party (A) if the indemnification of such Indemnified Party by Parent in the manner contemplated hereby is prohibited by applicable law, (B) the conduct of the Indemnified Party relating to the matter for which indemnification is sought involved bad faith or willful misconduct of such Indemnified Party, or (C) with respect to actions taken by any such Indemnified Party in his or its individual capacity, including, without limitations, with respect to any matters relating, directly or indirectly, to the purchase, sale or trading of securities issued by the Company other than a tender or sale pursuant to a stock tender agreement or (D) if such Indemnified Party shall have breached its obligation to cooperate with Parent in the defense of any claim in respect of which indemnification is sought and such breach (x) materially and adversely affects Parent's defense of such claim or (y) will materially and

adversely affect Parent's defense of such claim if such breach is not cured within ten days after notice of such breach is delivered to the Indemnified Party and such breach is not cured during such period.

(k) Financial Statements.

(i) As soon as they are made available to and reviewed by senior management of the Company, the Company shall make available to Parent the internally generated monthly, quarterly (including quarterly statements for the three-month period ended September 30, 1999) and annual financial statements of the Company, consisting of consolidated balance sheets, and consolidated statements of income and of cash flows.

(ii) As soon as they are made available to and reviewed by senior management of Parent, Parent shall make available to the Company the internally generated monthly, quarterly (including, quarterly statements for the three-month period ended September 30, 1999) and annual financial statements, consisting of consolidated balance sheets, and consolidated statements of income and of cash flows.

(l) Continuity of Business Enterprise. Parent, Surviving Corporation or any other member of the qualified group (as defined in Treasury Regulation §1.368-1(d)) shall, for the foreseeable future, continue at least one significant historic business line of the Company or use at least a significant portion of the Company's historic business assets in a business, in each case within the meaning of Treasury Regulation §1.368-1(d).

(m) Parent Board of Directors. At or before the Effective Time, the Board of Directors of Parent will take all action necessary to expand the size of the Parent Board of Directors by five directors and to:

(i) Elect the Chairman of the Board of the Company as a Class C director, to serve until the annual meeting of the Parent Stockholders in 2002;

(ii) Elect one independent director (as defined in National Association of Securities Dealers Rule 4200(a)(13)) designated by the Parent Board and one independent director (as so defined in relation to the Company) designated by Alfred West, who is currently serving on the Company Board, as Class B directors, to serve until the annual meeting of the Parent Stockholders in 2001; and

(iii) Elect the Chief Operating Officer of the Company and one person designated by the Parent Board (who need not qualify as an independent director) as Class A directors, to serve until the annual meeting of the Parent Stockholders in 2000.

In the event the Chairman of the Board of the Company is so elected and agrees to serve as a director of Parent, the Parent Board of Directors will appoint him as Vice Chairman of the Board of Parent.

(n) Rule 145 Affiliates. Prior to the Closing Date, the Company shall deliver to Parent a letter identifying all persons who were, at the date of the Company Special Meeting, "affiliates" of the Company for purposes of Rule 145 under the Securities Act. The Company shall use its reasonable efforts to cause each such person to deliver to Parent on or prior to the Closing Date a written agreement substantially in the form attached as Exhibit C.

(o) Nasdaq Listing. Parent shall use all reasonable efforts to cause the Parent Shares to be issued in connection with the Merger and under the Company Benefit Plans to be approved for listing on Nasdaq, subject to official notice of issuance, prior to the Closing Date.

(p) Tax Free Treatment. The Parties intend the Merger to qualify as a reorganization under Section 368(a) of the Code. Each Party and its Affiliates shall use reasonable efforts to cause the Merger to so qualify and to obtain the opinion referred to in § 6(b)(vii). For purposes of the tax opinion described in § 6(b)(vii), Parent and the Company shall provide customary representation letters substantially in the form of Exhibits D and E, each dated on or about the date that is two business days prior to the date the Joint Proxy Statement/Prospectus is mailed to the stockholders of Parent and the Company and reissued as of the Closing Date. Each of Parent, Parent Subsidiary and the Company and each of their respective Affiliates shall not take any action and shall not fail to take any action or suffer to exist any condition which action or failure to act or condition would prevent, or would be reasonably likely to prevent, the Merger from qualifying as a reorganization within the meaning of Section 368(a) of the Code.

(q) Company Employee Plans. After the Effective Time, Parent shall arrange for each employee participating in any of the Company Benefits Plans to participate in any counterpart benefit plans of Parent or its Subsidiaries (as appropriate) in accordance with the eligibility criteria thereof, provided that (i) such participants shall receive full credit for years of service with the Company or any of its Subsidiaries prior to the Effective Time for all purposes for which such service was recognized under the Company Benefit Plans and (ii) such participants shall participate in the Parent Benefit Plans on terms no less favorable than those offered by Parent to similarly situated employees of Parent or its Subsidiaries. Parent shall give credit under its applicable employee welfare benefit plans for all copayments, deductibles and out-of-pocket maximums satisfied by employees (and their eligible dependents) of the Company (and its Subsidiaries), in respect of the calendar year in which the Closing Date occurs. Parent shall waive all pre-existing conditions (to the extent waived under the applicable employee welfare benefit plans of the Company and its Subsidiaries) otherwise applicable to employees of the Company and its Subsidiaries under Parent's employee welfare benefit plans in which employees of the Company (and its Subsidiaries) become eligible to participate on or following the Closing. Notwithstanding the foregoing, Parent may continue (or cause the Surviving Corporation to continue) one or more of the Company Benefit Plans, in which case Parent shall have satisfied its obligations hereunder with respect to the benefits so provided if the terms of the Company Benefit Plans which are continued are no less favorable than the terms of the counterpart plans of Parent and its Subsidiaries (as applicable).

(r) Notice of Adverse Circe Network Developments. Parent will notify Company promptly after it becomes aware of any fact or circumstance that would be reasonably expected to materially delay or prevent the completion in all material respects of the Circe

Network within the periods described in the most recent Parent Report filed prior to the date hereof.

(s) Discount Notes. Parent and the Company agree to cooperate and use their reasonable efforts to obtain within 60 days after the date hereof any necessary consents, waivers or other modifications of the indenture dated as of April 8, 1998, between the Company and The Bank of New York, as trustee, governing the 11% Senior Discount Notes due 2008 issued by the Company, so as to avoid the obligation to conduct an Offer to Purchase pursuant to Section 4.12 thereof as a result of the transactions contemplated by this Agreement, provided that in connection with obtaining such consents, waivers or modifications neither the Company nor Parent will be required to make any payment or take any other action which is not commercially reasonable. The Company and Parent each shall pay one-half of all fees and expenses, including fees paid to holders of such notes, incurred by the Parties pursuant to this §5(s). If such consent, waiver or modification is not obtained within such 60 day period, the Parties may mutually agree to modify the terms of this Agreement so as to achieve the results of the transactions contemplated hereby in a manner that will not require such an Offer to Purchase to be undertaken.

(t) Year 2000 Budgets. Each of Parent and the Company shall, and shall seek to cause its executive officers to, (a) cooperate in good faith to develop a year 2000 combined budget for Parent and (b) provide such assistance as the other Party may reasonably require to develop a year 2000 combined budget.

6. Conditions to Obligation to Close.

(a) Conditions to Obligation of Parent and the Parent Subsidiary. The obligation of each of Parent and the Parent Subsidiary to consummate the Merger is subject to satisfaction or waiver by Parent or Parent Subsidiary of the following conditions at or prior to the Closing Date:

(i) this Agreement and the Merger shall have received the Requisite Stockholder Approvals;

(ii) the Company and its Subsidiaries shall have obtained the Required Company Consents, other than those Required Company Consents the failure of which to obtain would not reasonably be expected to have a Company Material Adverse Effect and the Purchaser shall have obtained the Required Parent Consents, other than those Required Parent Consents the failure of which to obtain would not reasonably be expected to have a Parent Material Adverse Effect;

(iii) the representations and warranties set forth in §3 above shall be true and correct in all material respects at and as of the Closing Date, except for those representations and warranties which address matters only as of a particular date (which shall have been true and correct as of such date);

(iv) the Company shall have performed and complied with all of its covenants hereunder in all material respects through the Closing;

(v) neither any statute, rule, regulation, order, stipulation or injunction (each an “Order”) shall be enacted, promulgated, entered, enforced or deemed applicable to the Merger nor any other action shall have been taken by any Government Entity (A) which prohibits the consummation of the transactions contemplated by the Merger; (B) which prohibits Parent’s or the Parent Subsidiary’s ownership or operation of all or any material portion of their or the Company’s business or assets, or which compels Parent or the Parent Subsidiary to dispose of or hold separate all or any material portion of Parent’s or the Parent Subsidiary’s or the Company’s business or assets as a result of the transactions contemplated by the Merger; (C) which makes the purchase of, or payment for, some or all of the Company Shares illegal; (D) which imposes material limitations on the ability of Parent or the Parent Subsidiary to acquire or hold or to exercise effectively all rights of ownership of Company Shares, including, without limitation, the right to vote any Company Shares purchased by Parent on all matters properly presented to the Company Stockholders; or (E) which imposes any limitations on the ability of Parent or the Parent Subsidiary, or any of their respective Subsidiaries, effectively to control in any material respect the business or operations of the Company or any of its Subsidiaries;

(vi) the Company shall have delivered to Parent and the Parent Subsidiary a certificate to the effect that each of the conditions specified above in §6(a)(i)-§6(a)(iv) is satisfied in all respects; *provided, however*, with respect to §6(a)(i), the Company shall only be required to certify that this Agreement and the Merger received the Requisite Stockholder Approval of the Company Stockholders;

(vii) all applicable waiting periods (and any extensions thereof) under the Hart-Scott-Rodino Act shall have expired or otherwise been terminated;

(viii) the Parent Shares to be issued in connection with the Merger shall have been approved upon official notice of issuance for quotation on Nasdaq, subject to official notice of issuance; and

(ix) the Registration Statement shall have been declared effective by the SEC under the Securities Act. No stop order suspending the effectiveness of the Registration Statement shall have been issued by the SEC and no proceedings for that purpose shall have been initiated or threatened by the SEC.

Subject to the provisions of applicable law, Parent and the Parent Subsidiary may waive, in whole or in part, any condition specified in this §6(a) if they execute a writing so stating at or prior to the Closing.

(b) Conditions to Obligation of the Company. The obligation of the Company to consummate the Merger is subject to satisfaction or waiver by the Company of the following conditions at or prior to the Closing Date:

(i) this Agreement and the Merger shall have received the Requisite Stockholder Approvals;

(ii) Parent and its Subsidiaries shall have obtained the Required Parent Consents, other than those Required Parent Consents the failure of which to obtain would not reasonably be expected to have a Parent Material Adverse Effect, and the Company and its Subsidiaries shall have obtained the Required Company Consents other than those Required Company Consents the failure of which to obtain would not reasonably be expected to have a material adverse effect on the business, financial condition or results of operations of Parent, the Surviving Corporation and their Affiliates taken as a whole;

(iii) the representations and warranties set forth in §4 above shall be true and correct in all material respects at and as of the Closing Date, except for those representations and warranties which address matters only as of a particular date (which shall have been true and correct as of such date);

(iv) each of Parent and the Parent Subsidiary shall have performed and complied with all of its covenants hereunder in all material respects through the Closing;

(v) neither any Order shall be enacted, promulgated, entered, enforced or deemed applicable to the Merger nor any other action shall have been taken by any Government Entity (A) which prohibits the consummation of the transactions contemplated by the Merger; (B) which prohibits Parent's or the Parent Subsidiary's ownership or operation of all or any material portion of their or the Company's business or assets, or which compels Parent or the Parent Subsidiary to dispose of or hold separate all or any material portion of Parent's or the Parent Subsidiary's or the Company's business or assets as a result of the transactions contemplated by the Merger; or (C) which makes the purchase of, or payment for, some or all of the Company Shares illegal;

(vi) each of Parent and the Parent Subsidiary shall have delivered to the Company a certificate to the effect that each of the conditions specified above in §6(b)(i)-(iv) is satisfied in all respects; *provided, however*, with respect to §6(b)(i), each of Parent and the Parent Subsidiary shall only be required to certify that this Agreement and the Merger received the Requisite Stockholder Approval of the Parent Stockholders;

(vii) The Company shall have received a written opinion, dated as of the Closing Date, from Cravath, Swaine & Moore, counsel to the Company, to the effect that the Merger will be treated for U.S. Federal income tax purposes as a reorganization within the meaning of Section 368(a) of the Code, and that Parent, Parent Subsidiary and the Company will each be a party to that reorganization within the meaning of Section 368(b) of the Code; it being understood that in rendering such opinion, such tax counsel shall be entitled to rely upon customary

representations provided by the Parties substantially in the form of Exhibits D and E;

(viii) all applicable waiting periods (and any extensions thereof) under the Hart-Scott-Rodino Act shall have expired or otherwise been terminated;

(ix) the Parent Shares to be issued in connection with the Merger shall have been approved upon official notice of issuance for quotation on Nasdaq, subject to official notice of issuance; and

(x) the Registration Statement shall have been declared effective by the SEC under the Securities Act. No stop order suspending the effectiveness of the Registration Statement shall have been issued by the SEC and no proceedings for that purpose shall have been initiated or threatened by the SEC.

Subject to the provisions of applicable law, the Company may waive, in whole or in part, any condition specified in this §6(b) if it executes a writing so stating at or prior to the Closing.

7. Termination.

(a) Termination of Agreement. The Parties may terminate this Agreement with the prior authorization of their respective board of directors as provided below:

(i) The Parties may terminate this Agreement, and the Merger may be abandoned, by mutual written consent at any time prior to the Effective Time before or after the approval by the Company Stockholders, the Parent Subsidiary stockholder or the Parent Stockholders;

(ii) This Agreement may be terminated and the Merger may be abandoned by action of the Board of Directors of either Parent or the Company, before or after the approval by the Company Stockholders, the Parent Subsidiary stockholders or the Parent Stockholders, (A) if the Effective Time shall not have occurred by June 30, 2000 (the "Outside Date") (unless the failure to consummate the Merger by such date is due to the action or failure to act of the Party seeking to terminate) or (B) if any condition to the obligation of the terminating Party to consummate the Merger shall have become incapable of being satisfied prior to the Outside Date as of a result of an Order that is final and non-appealable;

(iii) This Agreement may be terminated and the Merger may be abandoned at any time prior to the Effective Time, before or after the approval by the Company Stockholders, the Parent Subsidiary stockholder or the Parent Stockholders, by action of the Company Board, in the event that Parent or the Parent Subsidiary shall have breached any of their representations, warranties or covenants under this Agreement which breach (A) would give rise to the failure of a condition set forth in §6(b) above, and (B) cannot be or has not been cured within 30 days after the giving of written notice by the Company to Parent of such

breach (provided that the Company is not then in material breach of any representation, warranty or covenant contained in this Agreement):

(iv) This Agreement may be terminated and the Merger may be abandoned at any time prior to the Effective Time, before or after the approval by the Company Stockholders, the Parent Subsidiary stockholder or the Parent Stockholders, by action of the Parent Board, in the event that the Company shall have breached any of its representations, warranties or covenants under this Agreement which breach (A) would give rise to the failure of a condition set forth in §6(a) above, and (B) cannot be or has not been cured within 30 days after the giving of written notice by the Parent to the Company of such breach (provided that Parent is not then in material breach of any representation, warranty or covenant contained in this Agreement);

(v) This Agreement may be terminated by Parent, and the Merger may be abandoned, (A) if the Company Board (i) enters into or publicly announces its intention to enter into an agreement or agreement in principle with respect to an Acquisition Proposal, (ii) withdraws its recommendation to the Company Stockholders of this Agreement or the Merger or (iii) after the receipt of an Acquisition Proposal, fails to confirm publicly, within ten days after the request of Parent, its recommendation to the Company Stockholders that the Company Stockholders adopt and approve this Agreement and the Merger or (B) if the Company or any of its Representatives takes any of the actions that would be proscribed by §5(h) above, but for the exceptions therein allowing certain actions to be taken pursuant to the proviso in the first sentence of §5(h)(ii) above;

(vi) This Agreement may be terminated by the Company, and the Merger may be abandoned, (A) if the Parent Board (i) enters into or publicly announces its intention to enter into an agreement or agreement in principle with respect to a Prohibited Parent Acquisition Proposal, (ii) withdraws its recommendation to the Parent Stockholders that the Parent Stockholders approve the issuance of Parent Shares in connection with the Merger as provided by the Agreement or, if necessary, that the Parent Stockholders approve an amendment to the certificate of incorporation of Parent to increase the authorized number of Parent Shares or (iii) after receipt of a Parent Acquisition Proposal, fails to publicly confirm, within ten days after the request of the Company, its recommendation to the Parent Stockholders described in the foregoing clause (ii) or (B) if Parent or any of its Representatives takes any of the actions that would be proscribed by §5(i) but for the exceptions therein allowing certain actions to be taken pursuant to the proviso in the first sentence of §5(i)(ii);

(vii) This Agreement may be terminated by the Company, and the Merger may be abandoned, in the event that the Closing Sales Price per Parent Share on the Closing Date is less than \$25;

(viii) Any Party may terminate this Agreement, and the Merger may be abandoned, by giving written notice to the other Parties at any time after the

Company Special Meeting in the event that this Agreement and the Merger fail to receive the Requisite Stockholder Approval by the Company Stockholders; or

(ix) Any Party may terminate this Agreement, and the Merger may be abandoned, by giving written notice to the other Parties at any time after the Parent Special Meeting in the event that this Agreement and the Merger fail to receive the Requisite Stockholder Approval by the Parent Stockholders.

(b) Effect of Termination.

(i) Except as provided in clauses (ii) or (iii) of this §7(b), if any Party terminates this Agreement pursuant to §7(a) above, all rights and obligations of the Parties hereunder shall terminate without any liability of any Party to any other Party (except for any liability of any Party then in breach); *provided, however*, that the provisions of the Confidentiality Agreement, this §7(b) and §8 below, shall survive any such termination.

(ii) If this Agreement is terminated (A) by the Company pursuant to §7(a)(viii) or (B) by Parent pursuant to §7(a)(v) or §7(a)(viii), or (C) any Person makes an Acquisition Proposal that remains in effect on the date 60 days prior to the Outside Date and the Requisite Stockholder Approval of the Company Stockholders is not obtained prior to termination of this Agreement pursuant to §7(a)(ii), then, within five (5) days after such termination, the Company shall pay Parent the sum of \$30,000,000 in immediately available funds.

(iii) If (A) this Agreement is terminated pursuant to §7(a)(vi) or (B) any person makes a Prohibited Parent Acquisition Proposal that was publicly disclosed prior to the Parent Special Meeting but not publicly withdrawn more than ten days prior to the date of the Parent Special Meeting and thereafter this Agreement is terminated pursuant to §7(a)(ix) or (C) any person makes a Prohibited Parent Acquisition Proposal that remains in effect on the date 60 days prior to the Outside Date and the Requisite Stockholder Approval of the Parent Stockholders is not obtained prior to termination of this Agreement pursuant to §7(a)(ii), then, within five (5) days after such termination, Parent shall pay the Company the sum of \$75,000,000 in immediately available funds. If this Agreement is terminated pursuant to §7(a)(ix) and clause (B) or the preceding sentence is not applicable, then, within five (5) days after such termination, Parent shall pay the Company the sum of \$30,000,000 in immediately available funds.

8. Miscellaneous.

(a) Survival. None of the representations, warranties and covenants of the Parties (other than the provisions in §2 concerning payment of the Merger Consideration, the provisions in §5(j), §5(l), §5(m), §5(p) and §5(q) shall survive the Effective Time.

(b) Press Releases and Public Announcements. No Party shall issue any press release or make any public announcement relating to the subject matter of this Agreement without the prior written approval of the other Parties; *provided, however*, that any Party may

make any public disclosure it believes in good faith is required by applicable law or any listing or trading agreement concerning its publicly-traded securities (in which case the disclosing Party will use all reasonable efforts to advise the other Parties prior to making the disclosure).

(c) No Third-Party Beneficiaries. This Agreement shall not confer any rights or remedies upon any Person other than the Parties and their respective successors and permitted assigns; *provided, however*, that (i) the provisions in §2 above (A) concerning payment of the Merger Consideration are intended for the benefit of the Company Stockholders and (B) concerning the conversion of the stock options are intended for the benefit of the holders of such stock options, (ii) the provisions in §5(j) above concerning insurance and indemnification are intended for the benefit of the individuals specified therein and their respective legal representatives and (iii) the provisions of §5(l), §5(m) and §5(p) are intended for the benefit of the Company Stockholders.

(d) Entire Agreement. This Agreement (including the Confidentiality Agreement and the other documents referred to herein) constitutes the entire agreement among the Parties and supersedes any prior understandings, agreements or representations by or among the Parties, written or oral, to the extent they related in any way to the subject matter hereof.

(e) Binding Effect: Assignment. This Agreement shall be binding upon and inure to the benefit of the Parties and their respective successors and permitted assigns. No Party may assign or delegate either this Agreement or any of its rights, interests or obligations hereunder, by operation of law or otherwise, without the prior written approval of the other Parties. Any purported assignment or delegation without such approval shall be void and of no effect.

(f) Counterparts. This Agreement may be executed (including by facsimile) in one or more counterparts, each of which shall be deemed an original but all of which together will constitute one and the same instrument.

(g) Headings. The section headings contained in this Agreement are inserted for convenience only and shall not affect in any way the meaning or interpretation of this Agreement.

(h) Notices. All notices, requests, demands, claims and other communications hereunder shall be in writing. Any notice, request, demand, claim or other communication hereunder shall be deemed duly given if (and then two business days after) it is sent by registered or certified mail, return receipt requested, postage prepaid and addressed to the intended recipient as set forth below:

If to the Company:

Destia Communications, Inc.
95 Route 17 South
Paramus, New Jersey 07651
Attention: General Counsel
Facsimile: (201) 226-4575

with a Copy to:

Cravath, Swaine & Moore
Worldwide Plaza
825 Eighth Avenue
New York, New York 10019
Attention: Richard Hall
Facsimile: (212) 474-3700

If to Parent:

Viatel, Inc.
685 Third Avenue
New York, New York 10017
Attention: General Counsel
Facsimile: (203) 351-8023

with a Copy to:

Kelley Drye & Warren LLP
2 Stamford Plaza
281 Tresse Boulevard
Stamford, Connecticut 06901
Attention: John Capetta
Facsimile: (212) 350-7493

If to the Parent Subsidiary:

Viatel, Inc.
685 Third Avenue
New York, New York 10017
Attention: General Counsel
Facsimile: (212) 350-7493

with a Copy to:

Kelley Drye & Warren LLP
2 Stamford Plaza
281 Tresse Boulevard
Stamford, Connecticut 06901
Attention: John Capetta
Facsimile: (203) 351-8023

Any Party may send any notice, request, demand, claim or other communication hereunder to the intended recipient at the address set forth above using personal delivery, expedited courier, messenger service, telecopy or ordinary mail, but no such notice, request, demand, claim or other communication shall be deemed to have been duly given unless and until it actually is received by the intended recipient. Any Party may change the address to which notices, requests, demands, claims and other communications hereunder are to be delivered by giving the other Parties notice in the manner set forth in this §8(h), provided that no such change of address shall be effective until it actually is received by the intended recipient.

(i) GOVERNING LAW. THIS AGREEMENT SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE DOMESTIC LAWS OF THE STATE OF DELAWARE WITHOUT GIVING EFFECT TO ANY CHOICE OR CONFLICT OF LAW PROVISION OR RULE (WHETHER OF THE STATE OF DELAWARE OR ANY OTHER JURISDICTION) THAT WOULD CAUSE THE APPLICATION OF THE LAWS OF ANY JURISDICTION OTHER THAN THE STATE OF DELAWARE.

(j) Amendments and Waivers. The Parties may mutually amend any provision of this Agreement at any time prior to the Effective Time with the prior authorization of their respective boards of directors; *provided, however*, that any amendment effected subsequent to Requisite Stockholder Approval will be subject to the restrictions contained in the Delaware General Corporation Law, to the extent applicable. No amendment of any provision of this Agreement shall be valid unless the same shall be in writing and signed by all of the Parties. No waiver by any Party of any default, misrepresentation or breach of warranty or covenant hereunder, whether intentional or not, shall be deemed to extend to any prior or subsequent default, misrepresentation or breach of warranty or covenant hereunder or affect in any way any rights arising by virtue of any prior or subsequent such occurrence.

(k) Severability. Any term or provision of this Agreement that is invalid or unenforceable in any situation in any jurisdiction shall not affect the validity or enforceability of the remaining terms and provisions hereof or the validity or enforceability of the offending term or provision in any other situation or in any other jurisdiction.

(l) Expenses. Except as expressly set forth elsewhere in this Agreement, each of the Parties will bear its own costs and expenses (including legal fees and expenses) incurred in connection with this Agreement and the transactions contemplated hereby.

(m) Construction. The Parties have participated jointly in the negotiation and drafting of this Agreement. In the event an ambiguity or question of intent or interpretation arises, this Agreement shall be construed as if drafted jointly by the Parties and no presumption or burden of proof shall arise favoring or disfavoring any Party by virtue of the authorship of any of the provisions of this Agreement. Any reference to any federal, state, local or foreign statute or law shall be deemed also to refer to all rules and regulations promulgated thereunder, unless the context otherwise requires. The word "including" shall mean including without limitation. The phrase "business day" shall mean any day other than a day on which banks in the State of New York are required or authorized to be closed. Any disclosure made with reference to one or more sections of the Company Disclosure Letter shall be deemed disclosed with respect to each other section therein as to which such disclosure is relevant provided that such relevance is reasonably apparent. Disclosure of any matter in the Company Disclosure Letter or the Parent Disclosure Letter shall not be deemed an admission that such matter is material.

(n) Incorporation of Exhibits. The Exhibits identified in this Agreement are incorporated herein by reference and made a part hereof.

(o) Definition of Knowledge. As used herein, the words "knowledge", "best knowledge" or "known" shall, (i) with respect to the Company or Company management, mean the actual knowledge of the corporate executive officers of the Company, in each case after such

individuals have made due and diligent inquiry as to the matters which are the subject of the statements which are "known" by the Company or made to the "knowledge" or "best knowledge" of the Company, (ii) with respect to Parent or Parent management, mean the actual knowledge of the corporate executive officers of Parent, in each case after such individuals have made due and diligent inquiry as to the matters which are the subject of the statements which are "known" by Parent or made to the "knowledge" or "best knowledge" of Parent, and (iii) with respect to the Parent Subsidiary or the Parent Subsidiary management, mean the actual knowledge of the corporate executive officers of Parent or the Parent Subsidiary, in each case after such individuals have made due and diligent inquiry as to the matters which are the subject of the statements which are "known" by the Parent Subsidiary or made to the "knowledge" or "best knowledge" of the Parent Subsidiary.

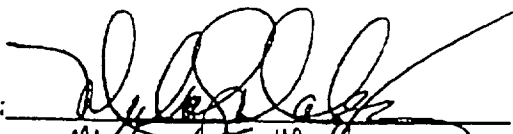
(p) WAIVER OF JURY TRIAL. EACH OF PARENT, THE PARENT SUBSIDIARY AND THE COMPANY, AND EACH INDEMNIFIED PARTY, HEREBY IRREVOCABLY WAIVES, TO THE FULLEST EXTENT PERMITTED BY LAW, ALL RIGHTS TO TRIAL BY JURY IN ANY ACTION, PROCEEDING OR COUNTERCLAIM (WHETHER BASED UPON CONTRACT, TORT OR OTHERWISE) ARISING OUT OF OR RELATING TO THIS AGREEMENT OR ANY OF THE TRANSACTIONS CONTEMPLATED HEREBY.

IN WITNESS WHEREOF, the Parties hereto have executed this Agreement as of the date first above written.

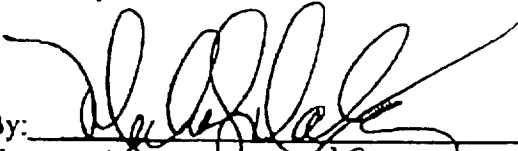
DESTIA COMMUNICATIONS, INC.

By: _____
Name:
Title:

VIATEL ACQUISITION CORP.

By: 
Name: Michael S. Mahoney
Title: President

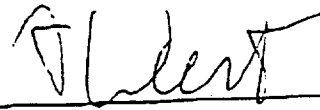
VIATEL, INC.

By: 
Name: Michael S. Mahoney
Title: President

AUG 27 1999 07:21 FR KDW-LLP

IN WITNESS WHEREOF, the Parties hereto have executed this Agreement as of the date first above written.

DESTIA COMMUNICATIONS, INC.

By: 
Name:
Title:

VIATEL ACQUISITION CORP.

By: _____
Name:
Title:

VIATEL, INC.

By: _____
Name:
Title

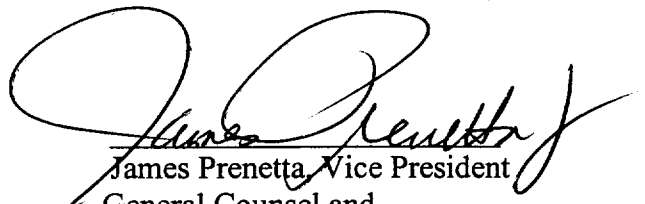
VIATEL, INC.

Officer's Certificate

I, James Prenetta, Vice President, General Counsel and Assistant Secretary of Viatel, Inc., a Delaware corporation (the "Corporation"), hereby certify that attached hereto as Exhibit A is a true and complete copy of the resolutions, duly adopted by the Board of Directors of the Corporation on August 26, 1999, in connection with the Company's contemplated acquisition of Destia Communications, Inc.

IN WITNESS WHEREOF, I have hereunto signed my name and affixed the seal of the Corporation.

Dated: September 16, 1999



James Prenetta, Vice President
General Counsel and
Assistant Secretary

AGREEMENT AND PLAN OF MERGER AND RELATED AGREEMENTS

RESOLVED, that the proper officers of the Corporation be, and they hereby are, and each of them hereby is, authorized and directed to execute and deliver the Forms of Stockholder Agreements by and among the Corporation, Viatel Acquisition Corp., a Delaware corporation and a wholly-owned subsidiary of Viatel ("Merger Sub"), and the Stockholder named therein, substantially in the forms attached hereto as Exhibits A, B, C and D, with such changes therein as the proper officer of the Corporation executing the same shall approve, such approval to be conclusively evidenced by the execution thereof by such proper officer; and be it further

RESOLVED, that the proper officers of the Corporation be, and they hereby are, and each of them hereby is, authorized and directed to execute and deliver the Form of Agreement and Plan of Merger, dated as of August 27, 1999 (the "Merger Agreement"), by and among the Corporation, Destia Communications, Inc. ("Destia") and Merger Sub, substantially in the form attached hereto as Exhibit E, with such changes therein as the proper officer of the Corporation executing the same shall approve, such approval to be conclusively evidenced by the execution thereof by such proper officer; and be it further.

RESOLVED, that the proper officers of the Corporation be, and they hereby are, and each of them hereby is, authorized and directed to execute and deliver the Forms of Employment Agreement between the Corporation and the executive named therein substantially in the forms attached hereto as Exhibits F and G with such changes therein as the proper officer of the Corporation executing the same shall approve, such approval to be conclusively evidenced by the execution thereof by such proper officer; and be it further

RESOLVED, that the incorporation of Merger Sub and the preparation of all necessary documentation in connection with the creation of Merger Sub be, and hereby is, ratified and confirmed; and be it further

SPECIAL MEETING

RESOLVED, that the proper officers of the Corporation be, and they hereby are, and each of them hereby is, authorized and directed to call a special meeting of the Corporation's stockholders to consider and act upon a proposal to adopt and approve the Merger Agreement and to transact any such other business as may properly come before the meeting or any adjournment or postponement thereof; and be it further

RESOLVED, that the Board hereby recommends approval and adoption of the Merger Agreement to the Corporation's stockholders and declares the merger, and the other transactions contemplated thereby, to be advisable and in the best interests of the Corporation's stockholders; and be it further

RESOLVED, that the proper officers of the Corporation be, and each of them hereby is, authorized and directed to (i) prepare the required proxy statement/prospectus and to mail, or cause to be mailed, to each stockholder of record as of the record date established for the special meeting, notice of the special meeting and any other required materials, (ii) all such other agreements and documents and to take all such action as such officers deem necessary or appropriate in connection with the Merger; and be it further

DELIVERY OF SHARES AND S-4 REGISTRATION STATEMENT

RESOLVED, that the signatures of proper officers of the Corporation on each share of common stock to be issued in exchange for outstanding shares of Destia may be by manual or facsimile signature; that such proper officers be, and each of them hereby is, authorized with respect to each such share to affix and attest, manually or by facsimile signature, the corporate seal of the Corporation; that each share of common stock of the Corporation issued in the exchange bearing the manual or facsimile signatures of individuals who were at the time officers of the Corporation shall bind the Corporation notwithstanding that such individuals or any of them cease to hold such office prior to the authentication or the delivery of any such shares of common stock; that the proper officers of the Corporation be, and each of them hereby is, authorized to deliver or cause to be delivered shares of common stock for authentication and delivery, and upon the authentication of any such shares of common stock, is authorized to deliver such shares as instructed by such proper officers of the Corporation; and be it further

RESOLVED, that the proper officers of the Corporation be, and each of them hereby is, authorized, empowered and directed, and behalf of the Corporation and in its name, to select and appoint a transfer agent,

exchange agent, paying agent and registrar and any other required agent in connection with the exchange of the Destia shares for shares of the Corporation for and on behalf of the holders thereof and the Corporation; and the proper officers of the Corporation be, and each of them hereby is, authorized to execute such agreements or other documents on behalf of the Corporation in connection therewith as such proper officers shall deem necessary or advisable in connection with the execution, delivery and performance of any such document, such execution, delivery and performance to be conclusive as to such approval; and the proper officers of the Corporation be, and each of them hereby is, authorized empowered and directed to take any other action as such proper officers deem necessary or advisable in connection with such appointment; and be it further

RESOLVED, that the proper officers of the Corporation or the exchange agent with respect to the shares be, and hereby are, authorized and instructed to record and countersign for original issuance certificates representing the shares and to issue such shares upon receipt of the appropriate notices and instructions; and be it further

RESOLVED, that upon the execution of the Corporation's Registration Statement on Form S-4 (the "Registration Statement") to be filed to register the Corporation's common stock to be issued in the exchange, and any amendments thereto, including post-effective amendments, by directors and officers of the Corporation, either in person or by duly authorized attorney or attorneys, the proper officers of the Corporation be, and each of them hereby is, authorized to cause the Registration Statement and amendments to be filed with the Securities and Exchange Commission (the "Commission") and to execute and file all such instruments, make all such payments and do such other acts and things as counsel for the Corporation shall advise or that the proper officers deem necessary, advisable or appropriate in order to effect such filing and to comply with the rules and regulations under the Securities Act of 1933 and the Securities Exchange Act of 1934, to cause the Registration Statement to become effective, and to maintain the Registration Statement in effect for as long as they deem it to be in the best interests of the Corporation or to terminate or delay the effectiveness of the Registration Statement if they deem it to be in the best interests of the Corporation; and be it further

RESOLVED, that Sheldon M. Goldman, Michael J. Mahoney and James P. Prenetta be, and each hereby is, designated and appointed, individually, as the agent for service of process of the Corporation for the receipt of notices or communications from the Commission with respect to the Registration Statement, with all the powers set forth in the rules and

regulations of the Commission under the Securities Act of 1933; and be it further

RESOLVED, that for the purposes of facilitating the signing and filing of any amendments to the Registration Statement or documents in connection therewith, Sheldon M. Goldman, Michael J. Mahoney and James P. Prenetta be, and each of them acting alone hereby is, designated as attorney-in-fact and agent of the Corporation, with full power of substitution and re-substitution and that the officers and directors of the Corporation be, and each of them hereby is, authorized to grant their several powers of attorney and the power of attorney of the Corporation to Sheldon M. Goldman, Michael J. Mahoney and James P. Prenetta, and each of them acting alone, with full power of substitution and re-substitution; and be it further

THIRD AMENDED AND RESTATED BYLAWS

RESOLVED, that the from of Third Amended and Restated Bylaws in the form attached hereto as Exhibit H be, and hereby is, adopted as the Bylaws of the Corporation; and be it further

MISCELLANEOUS

RESOLVED, that the proper officers of the Corporation be, and they hereby are, and each of them hereby is, authorized to prepare and file on behalf and in the name of the Corporation, all antitrust filings that may be required in connection with the merger with Destia; and be it further

RESOLVED, that as of the effective date of the merger, the number of directors constituting the full board shall be increased from 7 to 10; and be it further

RESOLVED, that the issuance of shares of the Corporation's common stock to current officers and directors of Destia in connection with the merger be, and hereby are, authorized pursuant to Rule 16b-3(d) of the Securities Exchange Act of 1934, as amended; and be it further

RESOLVED, that the proper officers of the Corporation be, and each of them hereby is, authorized, empowered and directed, on behalf of the Corporation and in its name, to prepare or cause to be prepared, verify, sign and file, or cause to be filed, a supplemental listing application on behalf of the Corporation with the Nasdaq National Market for listing thereon of the additional shares of common stock to be issued by the Corporation in connection with the merger; and be it further

GENERAL RATIFICATION

RESOLVED, that any and all actions hereto taken by the officers and other representatives of the Corporation in preparing, negotiating, executing, delivering and issuing, as the case may be, the Merger Agreement, the Stockholders Agreements, the Employment Agreements and each and every ancillary agreement contemplated thereby, and any and all other actions taken by such officers and representatives in furtherance thereof be, and they hereby are, ratified, approved and confirmed; and be it further

GENERAL AUTHORIZATION

RESOLVED, that each of the Secretary and any Assistant Secretary of the Corporation be, and hereby is, authorized to certify and deliver, to any person to whom such certification and delivery may be deemed necessary or advisable in the opinion of such Secretary or Assistant Secretary, a true copy of the foregoing resolutions; and be it further

RESOLVED, that all actions heretofore taken by any director or officer of the Corporation in connection with any matter referred to in the foregoing resolutions be, and hereby are, approved, ratified and confirmed in all respects; and be it further

RESOLVED, that the proper officers of the Corporation be, and each of them hereby is, authorized, empowered and directed, on behalf of the Corporation and in its name, to take such further actions and to negotiate, execute and deliver any and all certificates, agreements and other documents, to take any and all steps, and to do any and all acts and things which they, or any of them, may deem necessary, advisable or appropriate in connection with the foregoing resolutions.

Destia Communications, Inc.

Board of Directors
Resolutions

RESOLUTIONS

Merger Agreement and Merger

RESOLVED, that the Board of Directors hereby approves and declares it advisable that the Company enter into the Agreement and Plan of Merger (the "Merger Agreement") among the Company, Viatel Inc., a Delaware corporation ("Parent"), and Viatel Acquisition Corp., a Delaware corporation ("Merger Sub"); and that it is in the best interests of the Company's stockholders to combine the Company's business with the business of Parent; and be it further

RESOLVED, that the form, terms and conditions of the Merger Agreement, a copy of which has previously been submitted to the members of the Board of Directors pursuant to which, among other things, Merger Sub will be merged with and into the Company (the "Merger") in accordance with Section 251 of the General Corporation Law of the State of Delaware (the "DGCL"), be, and the same hereby are, in all respects approved; and be it further

RESOLVED, that, for Federal income tax purposes, it is intended that the Merger shall qualify as a tax-free reorganization within the meaning of Section 368(a) of the Internal Revenue Code of 1986, as amended, and the Merger Agreement is intended to be, and the same hereby is, in all respects approved by the Company as a plan of reorganization for such purpose; and be it further

RESOLVED, that the Chairman and Chief Executive Officer, the President and Chief Operating Officer, any Senior Vice President and any Vice President of the Company (the "Authorized Officers") be, and each of them with full power to act without the others hereby is, authorized to execute and deliver, in the name and on behalf of the Company, the Merger Agreement, in such form, with, to the extent permitted by law, such changes as the Authorized Officer executing the same may approve, such approval to be conclusively evidenced by such Authorized Officer's execution and delivery of the Merger Agreement; and be it further

RESOLVED, that the Merger Agreement be submitted to the stockholders of the Company for adoption as provided in the Merger Agreement at the Special Meeting (as hereinafter defined); and be it further

RESOLVED, that, if the stockholders of the Company adopt the Merger Agreement, and the other conditions set forth in the Merger Agreement have been satisfied or waived, the Authorized Officers be, and each of them with full power to act without the others hereby is, authorized and empowered to cause the Company to consummate the Merger in accordance with the terms of the Merger Agreement and to do any and all other acts and things and to enter into and execute any and all additional documents or instruments which in the opinion of such Authorized Officer shall be necessary or desirable in connection with the consummation of the Merger and the other transactions contemplated by the Merger Agreement; and be it further

RESOLVED, that the Authorized Officers be, and each of them with full power to act without the others hereby is, authorized and empowered to execute and file with the Secretary of State of the State of Delaware as soon as practicable on or after the closing of the Merger, in the name and on behalf of the Company, a certificate of merger in such form as the Authorized Officer executing the same may approve, such approval to be conclusively evidenced by such Authorized Officer's execution and delivery thereof.

Stockholder Agreements

RESOLVED, that the Board of Directors hereby approves the entering into by the Company of the Stockholder Agreements (the "Stockholder Agreements") among the Company, Parent, Merger Sub and each of Mr. Alfred West, Mr. Steven West, Mr. Gary Bondi and Princes Gate Investors II, L.P., and related entities (each, a "Stockholder"); and be it further

RESOLVED, that the Authorized Officers be, and each of them with full power to act without the others hereby is, authorized to execute and deliver, in the name and on behalf of the Company, the Stockholder Agreements, in such form, with, to the extent permitted by law, such changes as the Authorized Officer executing the same may approve, such approval

to be conclusively evidenced by such Authorized Officer's execution and delivery of the Stockholder Agreements.

Special Meeting; Proxy Statement

RESOLVED, that a special meeting (the "Special Meeting") of the stockholders of the Company shall be called for the purpose of submitting the Merger Agreement to the stockholders of the Company and that the Board of Directors shall have the authority to fix the date, time, place of and record date for determination of the stockholders of the Company entitled to notice of, and to vote at, the Special Meeting; and be it further

RESOLVED, that the Authorized Officers be, and each of them hereby is, authorized, in connection with the Special Meeting, to (a) approve the forms, terms and provisions of the notice of Special Meeting, proxy statement, proxy and voting instructions covering the matters to be submitted to the vote of the stockholders of the Company at the Special Meeting and other materials related thereto (the "Proxy Materials"), (b) mail a copy of the Proxy Materials to each stockholder of the Company of record as of the close of business on the record date to be established for the Special Meeting, (c) designate proxies to be named in the form of proxy to act on behalf of and to represent those stockholders who desire such representation at the Special Meeting in accordance with the provisions of such form of proxy and (d) engage a proxy solicitor with respect to the Special Meeting; and be it further

RESOLVED, that the Board of Directors hereby recommends to the stockholders of the Company that they vote for the adoption of the Merger Agreement; and be it further

RESOLVED, that the Authorized Officers and counsel for the Company be, and each of them hereby is, authorized and directed to prepare and file, in the name and on behalf of the Company, the Proxy

Materials with the Securities and Exchange Commission (the "SEC"); and be it further

RESOLVED, that the Authorized Officers be, and each of them with full power to act without the others hereby is, authorized and empowered to prepare or cause to be prepared, execute and file or cause to be filed with the SEC, in the name and on behalf of the Company, any and all amendments or supplements to the Proxy Materials, any revisions with respect to the Proxy Materials and any and all additional certificates, documents or instruments which in the opinion of such Authorized Officer shall be necessary or desirable, in such forms as such Authorized Officer may approve, such approval to be conclusively evidenced by such Authorized Officer's execution or filing thereof; and be it further

RESOLVED, that the Senior Vice President and General Counsel be, and hereby is, appointed the agent for service of process of the Company under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), in connection with the Proxy Materials, and any and all amendments and supplements thereto, with all the powers consequent to such appointment.

Filings and Approvals

RESOLVED, that in order for the Company to comply with all applicable requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the rules and regulations promulgated thereunder (the "HSR Act"), including the filings required to be made thereunder, the Authorized Officers be, and each of them with full power to act without the others hereby is, authorized and directed to prepare or cause to be prepared with the assistance of counsel, execute and file or cause to be filed, in the name and on behalf of the Company, all notifications, reports, statements, documents and information required to be filed by the Company pursuant to the HSR Act and to respond to all requests for additional information and to meet and confer or to cause counsel to meet and confer with officials of the Federal Trade Commission or the Antitrust Division of the Department of Justice, all in relation to the transactions contemplated by the Merger Agreement; and be it further

RESOLVED, that in order for the Company to comply with all applicable requirements of foreign competition laws and any rules and regulations promulgated thereunder, that the Authorized Officers be, and each of them hereby is, authorized and directed, in the name and on behalf of the Company, to prepare or cause to be prepared with the assistance of counsel, execute and file or cause to be filed, in the name and on behalf of the Company, all notifications, reports, statements, documents and information required to be filed by the Company pursuant to such laws, rules and regulations, and to respond to all requests for additional information and to meet and confer or to cause counsel to meet and confer with officials of foreign agencies that regulate competition, all in relation to the transactions contemplated by the Merger Agreement; and be it further

RESOLVED, that in order for the Company to comply with all applicable requirements of the Exchange Act and the Securities Act of 1933, as amended (the

"Securities Act"), and the rules and regulations promulgated thereunder, that the Authorized Officers be, and each of them hereby is, authorized and directed, in the name and on behalf of the Company, to prepare, execute, if appropriate, and file or cause to be filed all reports, statements, documents, information, amendments or supplements required to be filed by the Company pursuant to the Exchange Act and the Securities Act in connection with any of the transactions contemplated by the Merger Agreement, including, without limitation, the Proxy Materials; and be it further

RESOLVED, that in order for the Company to comply with all applicable requirements of the Communications Act of 1934, as amended, the rules and regulations promulgated by the Federal Communications Commission, the laws, rules, regulations, practices or orders of any state public service commission, local franchising authorities, foreign telecommunications regulatory agencies or similar state or foreign regulatory bodies, the Authorized Officers be, and each of them with full power to act without the others hereby is, authorized and directed to prepare or cause to be prepared with the assistance of counsel, execute and file or cause to be filed, in the name and on behalf of the Company, all registrations, reports, statements, documents and information required to be filed by the Company with the appropriate administrative or governmental agency or agencies as may be required in connection with any of the transactions contemplated herein; and be it further

RESOLVED, that, in order for the Company to comply with all other applicable requirements and regulations of the Federal, state, local and foreign administrative or governmental agencies in each jurisdiction where the Company or any of its subsidiaries conducts any business or owns any property or assets, the Authorized Officers be, and each of them with full power to act without the others hereby is, authorized and directed to prepare or cause to be prepared with the assistance of counsel, execute and file or cause to be filed, in the name and on behalf of the Company, all registrations, reports,

statements, documents and information required to be filed by the Company with any administrative or governmental agency or agencies as may, in their judgment, be required in connection with any of the transactions contemplated herein.

State Takeover Laws

RESOLVED, that the approval of the Merger Agreement is intended and shall be deemed to constitute the approval by the Board of Directors of the Company necessary to cause the restrictions set forth in Section 203 of the DGCL to be inapplicable to Parent or the Company in connection with the Merger and the other transactions contemplated by the Merger Agreement; and be it further

RESOLVED, that the approval of the Stockholder Agreements is intended and shall be deemed to constitute the approval by the Board of Directors of the Company necessary to cause the restrictions set forth in Section 203 of the DGCL to be inapplicable to Parent or the Company in connection with the Merger and the other transactions contemplated by the Merger Agreement; and be it further

RESOLVED, that the approval of the Merger Agreement and the Stockholder Agreements is intended and shall be deemed to constitute the approval by the Board of Directors of the Company necessary to cause, to the extent permitted by applicable law, the restrictions of any other state takeover law to be inapplicable to the Merger and the other transactions contemplated by the Merger Agreement.

Flexible Incentive Plans

RESOLVED, that, notwithstanding the provisions of the Company's Amended and Restated 1996 Flexible Incentive Plan ("1996 Plan") and the 1999 Flexible Incentive Plan ("1999 Plan"; together, the "Plans") which would otherwise take effect upon a "change of control" of the Company (as respectively defined in the Plans), prior to the effective time of the Merger, the Plans shall be amended to provide that all outstanding and unexercised rights thereunder to purchase the Company's common stock that, in the case of the 1996 Plan, are held by eligible employees, will at the effective time of the Merger be converted into rights to purchase common stock of the Parent in an amount and at an exercise price determined in accordance with the Merger Agreement.

Additional Actions

RESOLVED, that the Merger and the other transactions contemplated by the Merger Agreement are hereby approved; and be it further

RESOLVED, that the Authorized Officers be, and each of them with full power to act without the others hereby is, authorized and empowered to do any and all acts and things and to sign, seal, execute, acknowledge, file, deliver and record all papers, instruments, documents, deeds, releases, assignments, consents, tax returns, tax elections, bonds, proxy, power of attorney with full and general or limited authority with power of substitution and certificates or any other instrument similar or dissimilar to the preceding, and to pay all charges, fees, taxes and other expenses, from time to time necessary, desirable or appropriate to be done, signed, sealed, executed, acknowledged, filed, delivered, recorded or paid, under any applicable law or otherwise, in the name and on behalf of the Company, and the Secretary may certify as having been adopted by the Board of Directors of the Company any form of resolution required by any law, regulation or agency appropriate to effectuate the purpose and intent of these resolutions or any of them and the Merger Agreement and such

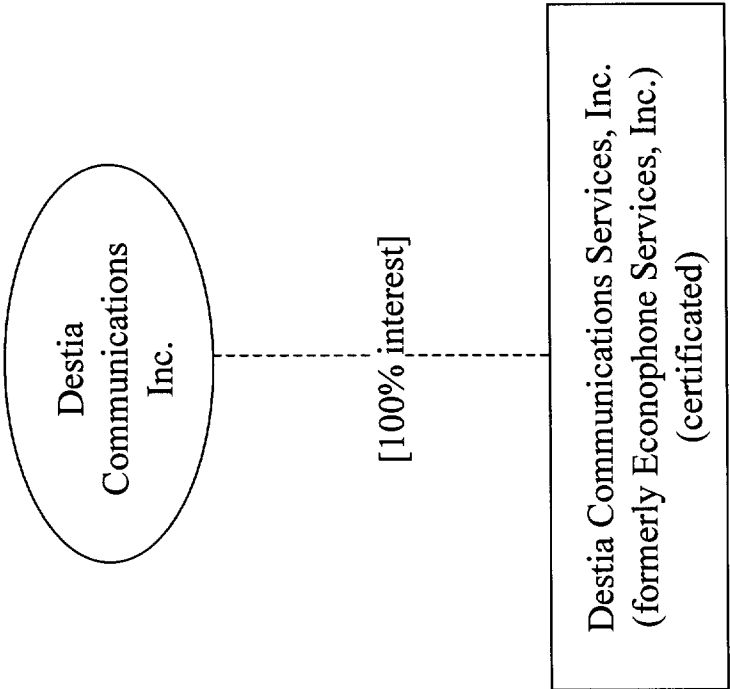
other agreements and documents as may be executed by any Authorized Officer pursuant to authorization granted in these resolutions or to carry out the transactions contemplated thereby; and be it further

RESOLVED, that the Authorized Officers be, and each of them with full power to act without the others hereby is, authorized and empowered to retain, in the name and on behalf of the Company, such financial advisors, legal counsel and such other advisors, consultants or experts necessary or appropriate to carry out the actions contemplated in these resolutions, and to secure any appropriate advice and opinions from such advisors, consultants or experts, and to pay all fees and expenses incurred by the Company in connection with the transactions contemplated by the Merger Agreement, including, but not limited to, all fees and expenses appropriate to effectuate the purpose and intent of the foregoing resolutions or any of them and the Merger Agreement and such other agreements and documents as may be executed by any Authorized Officer pursuant to authorization granted in these resolutions or to carry out the transactions contemplated thereby; and be it further

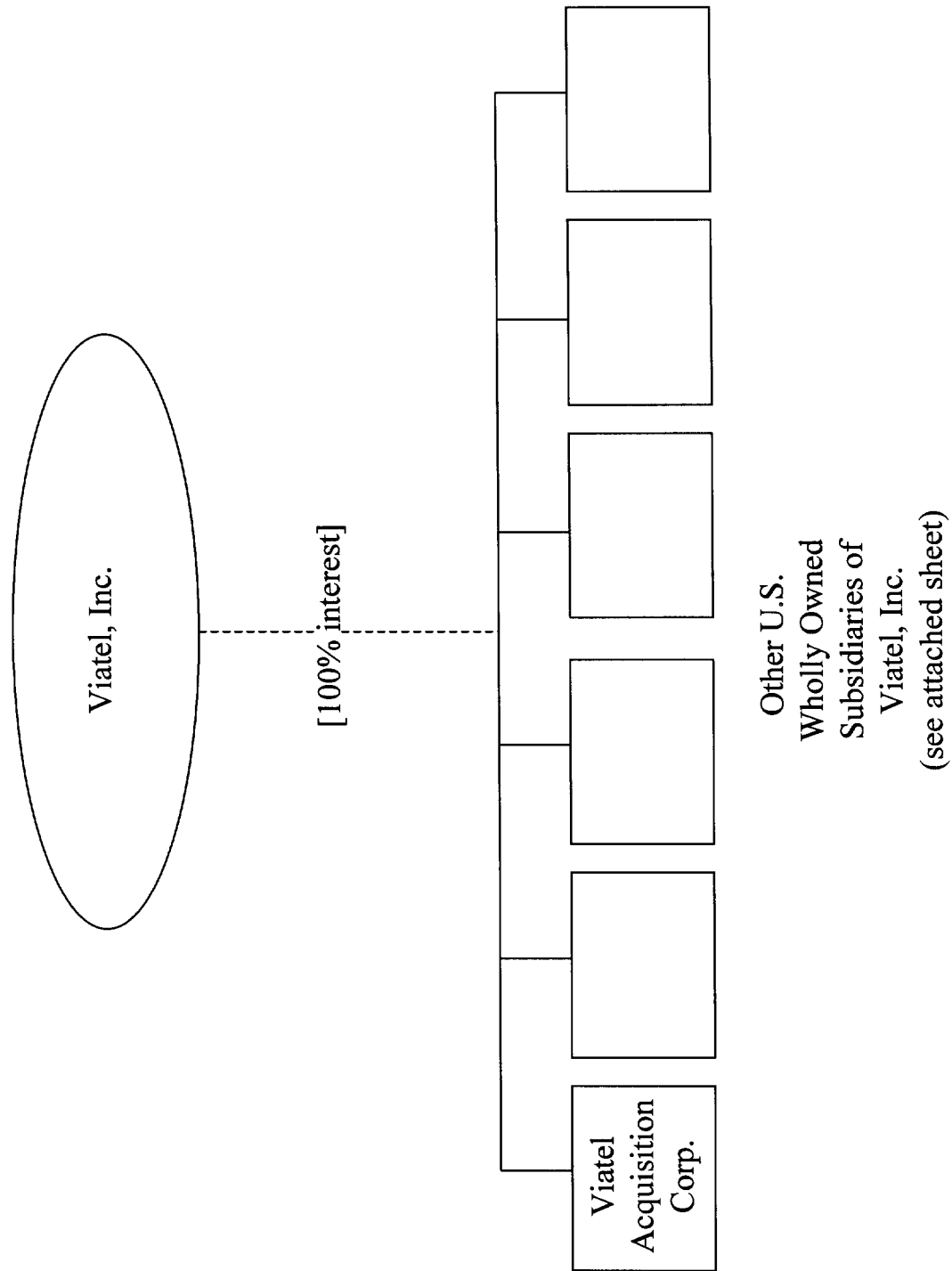
RESOLVED, that each Authorized Officer may authorize and delegate to any other officer, employee or agent of, or counsel to, the Company to take any and all actions and to execute and deliver any and all agreements, certificates, documents and instruments referred to in these resolutions in place of or on behalf of such Authorized Officer, with full power as if such Authorized Officer were taking such action himself; and be it further

RESOLVED, that any or all actions heretofore taken by any officer or officers of the Company with respect to any matter referred to or contemplated by any of the foregoing resolutions be, and hereby are, ratified and confirmed as the act and deed of the Company.

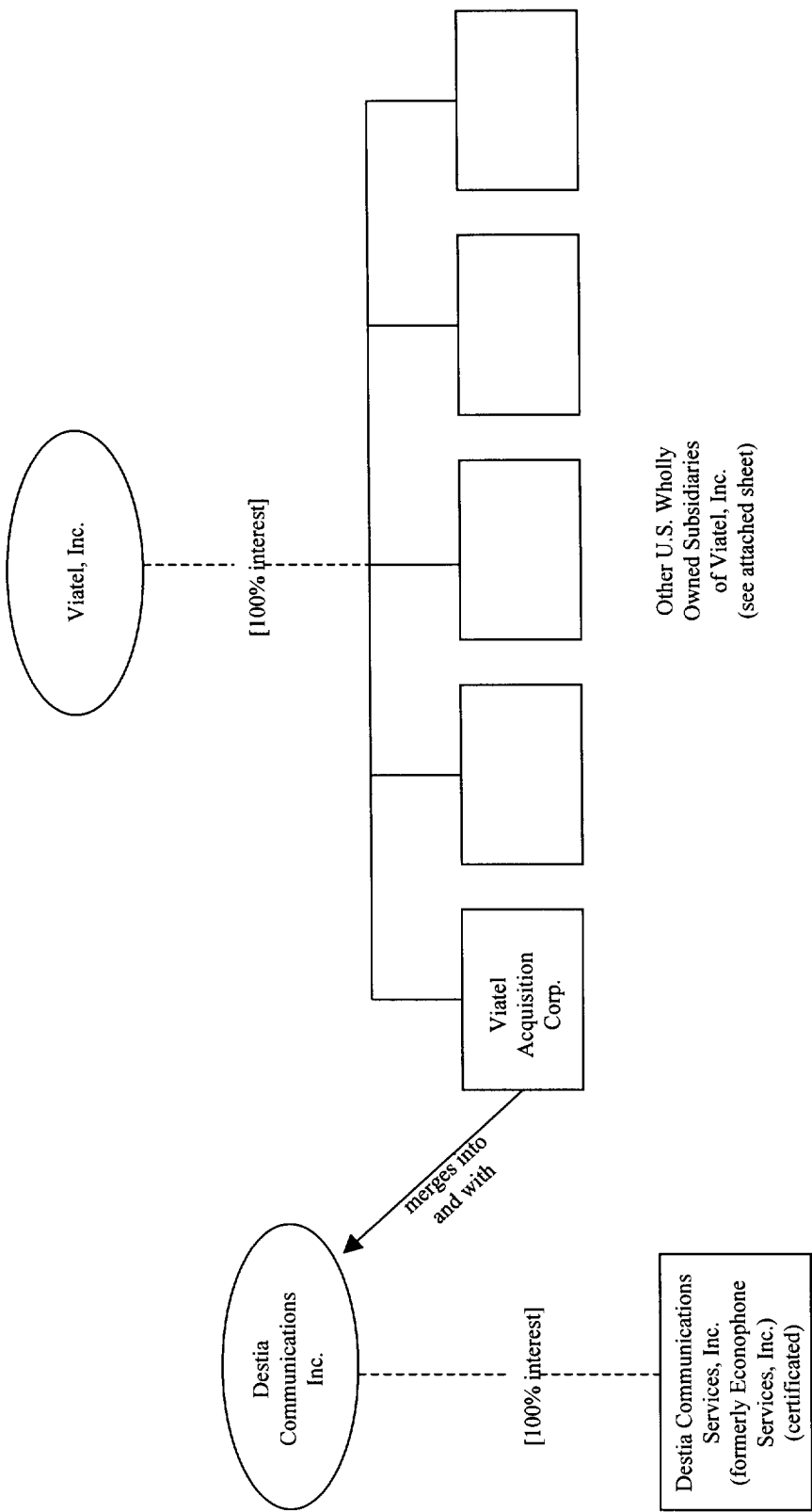
**Destia Corporate Structure
Before Merger**



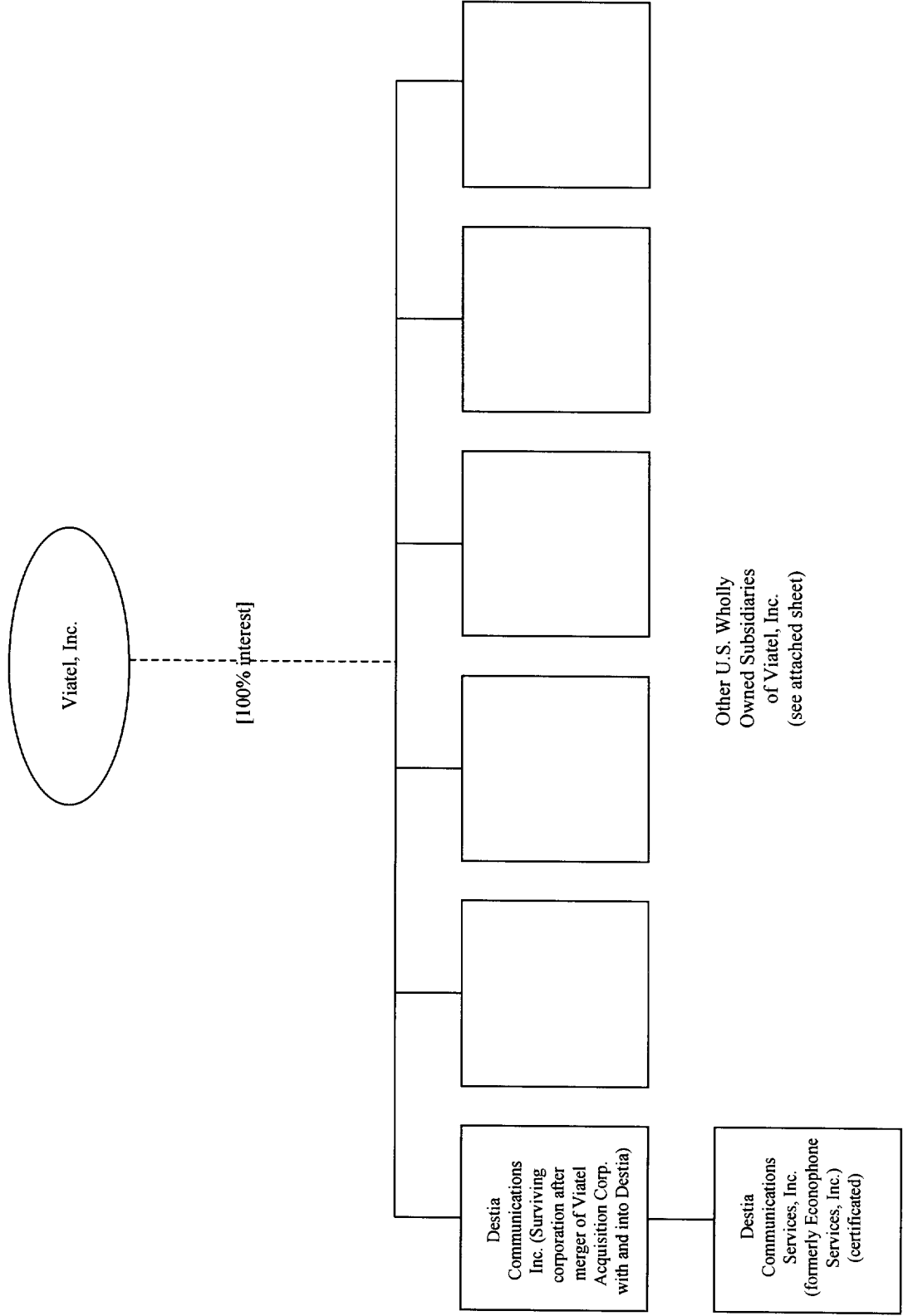
**Viatel Corporate Structure
Before Merger**



Effectuation of Merger



Viatel Corporate Structure After Merger



Wholly Owned Subsidiaries of Viatel, Inc. (U.S.)

Viatel Argentina Holdings, Inc.
Viatel Argentina Management, Inc.
 Viatel Brazil Holdings, Inc.
 Viatel Brazil Management, Inc.
Viatel Circe Cable System, Limited
 Viatel Colombia Holdings, Inc.
Viatel Colombia Management, Inc.
 Viatel Development Company
Viatel Finance Company, L.L.C.
 Viatel Finland, Inc.
Viatel Global Communications, Ltd.
 Viatel Nebraska, Inc.
 Viatel New Jersey, Inc.
 Viatel Sales U.S.A., Inc.
 Viatel Sweden, Inc.
 Viatel Virginia, Inc.
YYC Communications, Inc.

Pre-Merger Directors of Viatel, Inc.

Michael J. Mahoney	Chairman of the Board, Chief Executive Officer and President
Allan L. Shaw	Senior Vice President, Chief Financial Officer and Director
Lawrence G. Malone	Senior Vice President, Global Sales and Marketing
Sheldon M. Goldman	Senior Vice President, Business and Legal Affairs
Francis J. Mount	Senior Vice President, Chief Technology Officer
John G. Graham	Director
Paul G. Pizzani	Director

Pre-Merger Officers of Viatel, Inc.

Michael J. Mahoney	Chief Executive Officer and President
Allan L. Shaw	Senior Vice President, Finance, Chief Financial Officer
Lawrence G. Malone	Senior Vice President, Global Sales and Marketing
Sheldon M. Goldman	Senior Vice President, Business and Legal Affairs and Secretary
Francis J. Mount	Senior Vice President, Engineering and Network Operations
Glenn K. Davidson	Vice President, Corporate Communications
Charles T. Field	Vice President and Treasurer
Derek Foxwell	Vice President, Infrastructure Programs
Simon Joylon Gilling	Vice President, European Legal Affairs
Paul K. Heun	Vice President, Operations
Fred Hughes	Vice President, Engineering
Evan Miller	Vice President, Business Development
Wayne Myers	Vice President, European Sales
Jan S. Piazza	Vice President, Carrier Sales
James P. Prenetta	Vice President, General Counsel and Assistant Secretary
Ellen S. Rudin	Vice President, Deputy General Counsel and Assistant Secretary
Peter Stephens	Vice President, Operations - Europe

Post-Merger Senior Executives & Directors of Viatel, Inc.

Michael J. Mahoney	Chairman of the Board, Chief Executive Officer and President
Alfred West	Vice Chairman
Allan L. Shaw	Senior Vice President, Chief Financial Officer and Director
Lawrence G. Malone	Senior Vice President, Global Sales and Marketing
Sheldon M. Goldman	Senior Vice President, Business and Legal Affairs
Francis J. Mount	Senior Vice President, Chief Technology Officer
Allan L. Levy	Director, Chief Operating Officer
John G. Graham	Director
Paul G. Pizzani	Director

(Officer positions other than the Vice Chairman and Chief Operating Officer have yet to be determined.)

Secretary of State

Corporations Section

James K. Polk Building, Suite 1800

Nashville, Tennessee 37243-0306

DATE: 06/11/99

REQUEST NUMBER: 8695-2448

TELEPHONE CONTACT: (615) 741 2286

FILE DATE/TIME: 06/10/99 1410

EFFECTIVE DATE/TIME: 06/10/99 1410

CONTROL NUMBER: 0351264

TO:
CORP. GUARANTEE & TRUST CO
117 S 17TH ST
STE 701
PHILADELPHIA, PA 19103-5090

RE:
DESTIA COMMUNICATIONS SERVICES, INC.
APPLICATION FOR AMENDED CERTIFICATE OF
AUTHORITY - FOR PROFIT

THIS WILL ACKNOWLEDGE THE FILING OF THE ATTACHED DOCUMENT WITH AN
EFFECTIVE DATE AS INDICATED ABOVE.

WHEN CORRESPONDING WITH THIS OFFICE OR SUBMITTING DOCUMENTS FOR
FILING, PLEASE REFER TO THE CORPORATION CONTROL NUMBER GIVEN ABOVE.

FOR: APPLICATION FOR AMENDED CERTIFICATE OF
AUTHORITY - FOR PROFIT

ON DATE: 06/11/99

FROM:
CORPORATION GUARANTEE & TRUST CO
117 S. 17TH ST
SUITE 701
PHILADELPHIA, PA 19103-0000

RECEIVED: FEES \$20.00 \$0.00
TOTAL PAYMENT RECEIVED: \$20.00

RECEIPT NUMBER: 00002508282
ACCOUNT NUMBER: 00073224

Riley C. Darnell

**RILEY C. DARNELL
SECRETARY OF STATE**



State of Delaware
Office of the Secretary of State

PAGE 1 RECEIVED
STATE SECRETARY OF STATE
99 JUN 10 PM 2:11
SECRETARY OF STATE

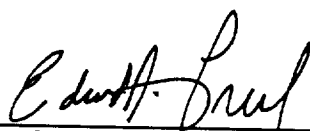
I, EDWARD J. FREEL, SECRETARY OF STATE OF THE STATE OF DELAWARE, DO HEREBY CERTIFY THAT THE SAID "ECONOPHONE SERVICES INC.", FILED A CERTIFICATE OF AMENDMENT, CHANGING ITS NAME TO "DESTIA COMMUNICATIONS SERVICES, INC.", THE THIRD DAY OF MARCH, A.D. 1999, AT 9 O'CLOCK A.M.

AND I DO HEREBY FURTHER CERTIFY THAT THE AFORESAID CORPORATION IS DULY INCORPORATED UNDER THE LAWS OF THE STATE OF DELAWARE AND IS IN GOOD STANDING AND HAS A LEGAL CORPORATE EXISTENCE NOT HAVING BEEN CANCELLED OR DISSOLVED SO FAR AS THE RECORDS OF THIS OFFICE SHOW AND IS DULY AUTHORIZED TO TRANSACT BUSINESS.



2864970 8320

991211830



Edward J. Freel, Secretary of State

AUTHENTICATION: 9770421

DATE: 05-27-99

APPLICATION FOR AMENDED CERTIFICATE OF AUTHORITY

FILED

STATE RECORDED
99 JUN 10 PM 2:10
SECRETARY OF STATE

To the Secretary of State of the State of Tennessee:

Pursuant to the provisions of Section 48-25-104 of the Tennessee Business Corporation Act, the undersigned corporation hereby applies for an amended certificate of authority to transact business in the State of Tennessee, and for that purpose sets forth:

1. The name of the corporation is ECONOPHONE SERVICES INC.

If different, the name under which the certificate of authority is to be obtained is _____

Name Change: DESTIA COMMUNICATIONS SERVICES, INC.

2. The state or country under whose law it is incorporated is Delaware

3. The date of its incorporation is February 27, 1998 (must be month, day, and year), and the period of duration, if other than perpetual, is perpetual

4. The complete street address (including zip code) of its principal office is 95 Route 17 South,

	<u>Paramus,</u>	<u>NJ</u>	<u>07652</u>
Street	City	State/Country	Zip Code

5. The complete street address (including the county and the zip code) of its registered office in Tennessee is

<u>230 Fourth Avenue, North, 3rd Floor, Nashville,</u>	<u>Davidson,</u>	<u>TN</u>	<u>37219</u>
Street	City/State	County	Zip Code

The name of its registered agent at that office is Joseph Martin, Jr.

6. The names and complete business addresses (including zip code) of its current officers are: (Attach separate sheet if necessary.)

SEE ATTACHED LIST

7. The names and complete business addresses (including zip code) of its current board of directors are: (Attach separate sheet if necessary.)

SEE ATTACHED LIST

8. The corporation is a corporation for profit.

9. If the document is not to be effective upon filing by the Secretary of State, the delayed effective date/time is _____, 19____ (date), _____ (time).

[NOTE: A delayed effective date shall not be later than the 90th day after the date this document is filed by the Secretary of State.]

[NOTE: This application must be accompanied by a certificate of existence (or a document of similar import) duly authenticated by the Secretary of State or other official having custody of corporate records in the state or country

Destia Communications Services, Inc.

Directors & Senior Officers

April 1999

Directors:

Alfred West	95 Route 17 South	Paramus, NJ 07652
Alan Levy	95 Route 17 South	Paramus, NJ 07652
Richard Shorten	95 Route 17 South	Paramus, NJ 07652
Phil Storin	95 Route 17 South	Paramus, NJ 07652

Senior Officers:

Alfred West	Chief Executive Officer	95 Route 17 South Paramus, NJ 07652
Alan Levy	President and Chief Operating Officer	95 Route 17 South Paramus, NJ 07652
Kevin Alward	President-North America	95 Route 17 South Paramus, NJ 07652
Phillip Storin	Senior Vice President and Chief Financial Officer Treasurer	95 Route 17 South Paramus, NJ 07652
Richard Shorten	Senior Vice President and General Counsel Secretary	95 Route 17 South Paramus, NJ 07652
John Crudele	Assistant Secretary	95 Route 17 South Paramus, NJ 07652
Scott Ellison	Assistant Secretary	95 Route 17 South Paramus, NJ 07652
David Lacher	Assistant Secretary	95 Route 17 South Paramus, NJ 07652
Brett Lawrence	Assistant Secretary	95 Route 17 South Paramus, NJ 07652
Blake Reiser	Assistant Secretary	95 Route 17 South Paramus, NJ 07652

RECEIVED
STATE OF TENNESSEE
99 JUN 10 PM 2:10
SECRETARY OF STATE

Secretary of State

Corporations Section

James K. Polk Building, Suite 1800

Nashville, Tennessee 37243-0306

ISSUANCE DATE: 09/10/1999
REQUEST NUMBER: 99253002
TELEPHONE CONTACT: (615) 741-6488

CHARTER/QUALIFICATION DATE: 05/19/1998
STATUS: ACTIVE
CORPORATE EXPIRATION DATE: PERPETUAL
CONTROL NUMBER: 0351264
JURISDICTION: DELAWARE

TO:
CORPORTION GUARANTEE& TRUST CO
ATTN JOSEPH COLLOPY
117 S 17TH ST #701
PHILADELPHIA, PA 19103-5090

REQUESTED BY:
CORPORTION GUARANTEE& TRUST CO
ATTN JOSEPH COLLOPY
117 S 17TH ST #701
PHILADELPHIA, PA 19103-5090

CERTIFICATE OF AUTHORIZATION

I, RILEY C DARNELL, SECRETARY OF STATE OF THE STATE OF TENNESSEE DO HEREBY CERTIFY THAT

"DESTIA COMMUNICATIONS SERVICE, INC.",

A CORPORATION FORMED IN THE JURISDICTION SET FORTH ABOVE, IS AUTHORIZED TO
TRANSACTION BUSINESS IN THIS STATE;
THAT ALL FEES, TAXES, AND PENALTIES OWED TO THIS STATE WHICH AFFECT THE
AUTHORIZATION OF THE CORPORATION HAVE BEEN PAID;
THAT THE MOST RECENT CORPORATION ANNUAL REPORT REQUIRED HAS BEEN FILED
WITH THIS OFFICE; AND
THAT AN APPLICATION FOR CERTIFICATE OF WITHDRAWAL HAS NOT BEEN FILED.

FOR: REQUEST FOR CERTIFICATE

ON DATE: 09/10/99

FROM:
CORPORATION GUARANTEE & TRUST CO
117 S. 17TH ST
SUITE 701
PHILADELPHIA, PA 19103-0000

RECEIVED:	FEES	
	\$20.00	\$0.00
TOTAL PAYMENT RECEIVED:		\$20.00

RECEIPT NUMBER: 00002546650
ACCOUNT NUMBER: 00073224



Riley C Darnell

RILEY C. DARNELL
SECRETARY OF STATE